IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11 Cases
	)	
The SCO GROUP, INC. et al.,	)	Case No. 07-11337 (KG)
	)	(Jointly Administered)
Debtors.	)	**Related Docket No. 89**

DEBTORS' MEMORANDUM OF LAW IN RESPONSE TO NOVELL, INC.'S MOTION FOR RELIEF FROM AUTOMATIC STAY TO PROCEED WITH DISTRICT COURT ACTION TO (I) APPORTION REVENUE FROM SCOSOURCE LICENSES AND (II) DETERMINE SCO'S AUTHORITY TO ENTER INTO SCOSOURCE LICENSES, ETC.

The SCO Group, Inc. ("SCO Group") and SCO Operations, Inc. ("Operations") (collectively, "SCO" or the "Debtors"), oppose Novell, Inc.'s motion for relief from the automatic stay ("Motion")[1] in which Novell requests, *inter alia*, this Court to abstain from the responsibility it exclusively has to determine what is or is not property of the estate. Respectfully, Novell's motion should be denied because the determination it seeks another court to make is the most core of core decisions and to get the answer wrong would doom this reorganization before it has a chance to begin. Moreover, there is no demonstrable need to have the issues that are the subject of Novell's Motion decided before confirmation of a plan of reorganization.

SCO resists the Motion because: (1) the issue of what funds, if any, are subject to the imposition of a constructive trust is a matter that should be determined in this Court, as it is

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[1] The motion in question is *Novell, Inc.'s Motion for Relief from Automatic Stay to Proceed with District Court Action to (i) Apportion Revenue from ScoSource Licenses and (ii) to Determine SCO's authority to Enter into SCOSource Licenses, Etc.* (the "Motion")(D.E. #89).

not a matter on which the District Court has any substantial involvement, and instead, is a central, core bankruptcy issue; (2) in the future, after confirmation of a plan, it will be appropriate for the District Court in Utah to determine remaining issues – except for the constructive trust question – so that the central issues of copyright ownership and other matters determined by the summary judgment rulings can proceed on appeal to the Tenth Circuit; and (3) to vacate the automatic stay at the present time is not only unjustified but would also unnecessarily divert management attention at a time when the Debtors are making substantial progress toward presenting a plan of reorganization that will benefit the estate and all creditors.

Procedural and Factual Background

1. On September 14, 2007 (the "Petition Date"), the Debtors commenced these cases by filing voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

2. The Debtors are operating their businesses and managing their affairs as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

3. SCO is a leading provider of software technology for distributed, embedded, network-based, and mobile systems, offering SCO OpenServer for small to medium business, UnixWare, and SCO Mobile Server for enterprise applications and digital network services. Operations is a Delaware corporation that is wholly owned by SCO Group and operates the research, development, sales and implementation of technology owned by SCO Group.

4. SCO's core business focus is to serve the needs of small-to-medium sized businesses and branch offices and franchisees of Fortune 1000 companies, by providing reliable,

cost-effective UNIX software technology for distributed, embedded and network-based systems. Many companies around the world use SCO's products and services to run mission critical systems in those companies. SCO also provides a full range of pre- and post-sales technical support for all of its products, primarily focusing on OpenServer and UnixWare. Additionally, SCO provides UNIX-based technical support services and consulting services.[2]

5. As of the Petition Date, SCO Group was a party to a number of lawsuits that, along with the its current financial condition, ultimately led to the filing of these Chapter 11 cases, including the lawsuit that is referenced in the Motion. A brief description of the Novell Litigation is set forth below.[3]

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[2] For a much more detailed description of the Debtors and their operations, the Debtors respectfully refer the Court and parties in interest to the *Declaration of Darl C. McBride, Chief Executive Officer, in Support of First Day Pleadings* (the "McBride Declaration") that was previously filed in support of various first day motions, and which is incorporated herein by reference.

[3] In addition, SCO Group is also a party to another other major lawsuit that was pending as of the Petition Date. On or about March 6, 2003, SCO filed a civil complaint against International Business Machines Corporation ("IBM"). The case is pending in the United States District Court for the District of Utah, under the caption *The SCO Group, Inc. v. International Business Machines Corporation*, Case No. 2:03CV0294 (the "IBM Litigation"). In that action, SCO Group claims that IBM breached its UNIX source code and related agreements by disclosing to Linux developers source code and methods and concepts from UNIX and derivative works, in violation of these contractual restrictions. On February 27, 2004, SCO Group filed a second amended complaint which added claims for copyright infringement, unfair competition arising from IBM's misappropriation of source code from a joint venture with SCO called "Project Monterey" that was then wrongly placed into IBM's proprietary products, and tortious interference. IBM asserted counterclaims including claims for breach of contract, violation of the Lanham Act, unfair competition, intentional interference with prospective economic relations, unfair and deceptive trade practices, promissory estoppel, and a declaratory judgment claim for non-infringement of copyrights. (IBM also asserted but later dropped several claims of patent infringement). IBM and SCO Group conducted extensive fact and expert discovery. Both IBM and SCO Group filed motions for summary judgment that were fully briefed and argued, but have not been decided. That being said, several of SCO Group's claims against IBM have been effectively dismissed pursuant to the summary judgment entered in the Novell Litigation (described above) on August 10, 2007. The court ruled that Novell had the right to direct SCO Group to waive certain of its contractual claims against IBM.

SCO Group is also the defendant in an action by Red Hat, Inc., pending on the Petition Date in the United States District Court for the District of Delaware under the case caption, *Red Hat, Inc. v. The SCO Group, Inc.*, Civil No. 03-772. Red Hat seeks a declaratory judgment for non-infringement of copyrights and no misappropriation of trade secrets, asserting that the Linux operating system does not infringe on SCO Group's UNIX intellectual property rights. In addition, Red Hat claims that SCO Group had engaged in false advertising in violation of the Lanham Act, deceptive trade practices, unfair competition, tortious interference with prospective business opportunities, trade libel and disparagement. The Delaware court has stayed the case pending the outcome of the IBM Litigation and requires reports every 90 days on the status thereof.

6. On January 20, 2004, SCO Group filed a lawsuit in Utah state court against Novell asserting slander of title and seeking relief for Novell's alleged bad faith effort to interfere with SCO Group's ownership of copyrights related to the company's UNIX source code and derivative works and UnixWare product. The case was removed by Novell to the United States District Court for the District of Utah and is styled *The SCO Group, Inc. v. Novell, Inc.*, Case No. 2:04CV00139 (the "Novell Litigation"). In the lawsuit, SCO Group sought injunctive relief as well as damages.

7. Novell asserted counterclaims alleging breaches of the Asset Purchase Agreement between Novell and SCO Group's predecessor-in-interest, The Santa Cruz Operation, for slander of title, restitution/unjust enrichment, an accounting related to Novell's retained binary royalty stream, and for declaratory relief regarding Novell's alleged rights under the Asset Purchase Agreement.

8. SCO Group subsequently amended the complaint against Novell to assert additional claims including copyright infringement, unfair competition and a breach of a technology licensing agreement from Novell's distribution of Linux.

9. On or about April 10, 2006, Novell filed a motion to stay the case pending a request for arbitration that Novell's wholly owned subsidiary, SuSE Linux, GmbH ("SuSE"), filed (on the same date) in the International Court of Arbitration in France (the "SuSE Arbitration"). The SuSE Arbitration asserts that SCO Group granted SuSE the right to use SCO's intellectual property through SCO Group's participation in the UnitedLinux initiative in

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SCO is also party to an action it initiated against Autozone to enforce its intellectual property rights. That action is pending in the United States District Court for the District of Nevada and has been stayed.

2002. The District Court ordered that portions of claims relating to the SuSE Arbitration should be stayed but the other portions of claims in the case should proceed. An arbitration panel has been selected for the SuSE Arbitration in Switzerland, and that process has commenced. The next phase of that arbitration is scheduled for hearing in December 2007 and is the subject of a separate motion before this Court to enforce the automatic stay with respect to that matter.

10. Meanwhile, in September 2006, Novell filed an Amended Counterclaim in the federal action in Utah alleging that SCO's retention of funds from licensing agreements SCO had entered in 2003 with Microsoft Corporation and Sun Microsystems, and from certain SCOSource licenses, constituted a breach of fiduciary duty, breach of contract, and conversion. Novell sought imposition of a constructive trust over these funds. In October 2006, Novell moved for summary judgment with respect to these claims, and, in the alternative, for a preliminary injunction to prevent SCO from expending such funds. This motion was fully briefed, and argued in January, 2007. No preliminary injunction was ever issued.

11. Both SCO and Novell filed multiple motions for summary judgment on their respective claims and counterclaims in the lawsuit in Utah. On August 10, 2007, the District Court denied SCO Group's motion for summary judgment and granted certain of Novell's motions for summary judgment. Briefly summarized, the District Court held that Novell retained ownership of the pre-1996 UNIX and Unixware copyrights and did not transfer those copyrights with the sale of the Unix business in 1995 to SCO's predecessor, Santa Cruz Operation. The District Court also held that Novell was entitled to waive SCO's claims against IBM for breach of software licenses. With respect to the issues that most immediately concern

this Motion, the court ruled that Novell retained the right to royalties on new SVRX licenses SCO entered, regardless of the nature of those agreements or whether the SVRX rights were ancillary to a Unixware license.[4] As a result of the court's interpretation of the contractual language, it found that Novell was entitled to a partial summary judgment on its claims for breach of fiduciary duty and conversion. While the District Court held that imposition of a constructive trust was warranted in theory,[5] the Court denied that part of Novell's motion for partial summary judgment seeking the imposition of a constructive trust until it could determine the appropriate amount of SVRX Royalties, and left this determination for trial.

12. The District Court's summary judgment in favor of Novell held that Novell was entitled to receive at least some portion of the funds received by SCO Group in 2003 from SCO's agreements with Sun Microsystems and Microsoft. SCO and Novell sharply dispute how much of the funds in question should be allocated to the SVRX Royalties under the District Court's interpretation. Novell claims that it should be entitled to a large but unquantified percentage of the Microsoft and Sun payments and to all of the other SCOSource agreements. The total amount subject to allocation is in excess of $26 million, and, with interest, in excess of $37 million. Novell continues to seek the imposition of a constructive trust on whatever such funds are currently in SCO Group's possession that can be properly traced backed to those transactions. Thus, the trial before the District Court was to decide three issues: (1) the proper

[4] SVRX licenses referred to the legacy System V version of Unix that was created well before the sale of the business in 1995. Unixware was the more current product sold by SCO, and which is not subject to the royalty retention which relates solely to SVRX licenses. The Asset Purchase Agreement did not expressly identify the SVRX licenses covered by the royalty provision, which led to the dispute between Novell and SCO over the proper interpretation of that provision.

[5] The District Court did *not* impose a constructive trust on any funds in SCO's possession.

amount of the SVRX Royalties to which Novell is entitled; (2) whether the Sun and Microsoft Agreements were entered into without proper authority; and (3) the amount of funds currently in SCO's possession that can be properly traced to the payments made to SCO and thus, subject to a constructive trust. In its trial brief, Novell urged that the last issue – that of a constructive trust – be decided by the court in a separate hearing after the trial on the other two issues.

13. On September 7, 2007, several days before the filing of SCO's Chapter 11 petition, the District Court denied SCO's motion for entry of a final judgment under Fed.R.Civ.P. 54(b) on the claims resolved by the summary judgment ruling. SCO had requested the court to do so to facilitate the taking of an appeal to the Tenth Circuit on these issues;[6] Novell opposed this motion.[7]

14. Novell filed the instant Motion on October 4, 2007. In the Motion, Novell argued that "cause" exists to grant it stay relief so that it can proceed with a trial in the Novell Litigation. Novell argues that cause exists

> *so that Novell may proceed with all remaining issues in the [Novell Litigation] by whatever means are appropriate* and consistent with the District Court's schedule in order to have its claims liquidated, including allowing the District Court to (I) apportion revenue from certain SCOsource licenses that the District Court had determined or determines that SCO wrongfully retained, (II) determine SCO's authority to enter into SCOsource licenses generally. . . .

Motion at p. 14. (Emphasis added). *See also id.* at p. 3 ("By this Motion, Novell seeks to lift the automatic stay to resolve the issues that were before the District Court, including those issues

[6] SCO intends to appeal the District Court's summary judgment in favor of Novell, and its denial of SCO's own motion for summary judgment.

[7] After receiving notice of this bankruptcy case, the District Court entered one more order, denying SCO's motion for reconsideration or clarification of one aspect of the summary judgment ruling.

that were the subject of the five-day trial on its counterclaims.").[8] The thrust of Novell's argument is that the District Court in Utah is familiar with the issues to be tried, and is, therefore, the most logical court in which to conduct a trial of the remaining issues. Novell also asserts that the estate will not be harmed by the granting of stay relief since the issues need to be addressed before there can be a Chapter 11 reorganization. Motion at p. 14. However, in its analysis, Novell completely ignores one of the most important interests in a Chapter 11 case: the rights of the estate and its creditors. Moreover, its premise that the issues need to be decided *before* the Debtors can complete a Chapter 11 reorganization is simply not true. The Motion should be denied.[9]

Argument

A. Purpose of the Automatic Stay

The immediate imposition of the automatic stay is one of the fundamental rights that filing a bankruptcy case affords a debtor-in-possession. As stated by one court: "[T]he automatic stay is the single most important protection afforded to debtors by the Bankruptcy Code." *In re Cavanaugh*, 271 B.R. 414, 424 (Bankr. D. Mass. 2001). Indeed, the Third Circuit recognized that this was a protection that Congress envisioned in enacting §362. *See In re*

[8] As set forth in the Motion, the trial in the Novell Litigation was to encompass "the remaining issues between [SCO] and Novell, Inc." Motion, p. 1. *See also id.* at p. 5 ("Following the District Court Order, the parties were scheduled to try Novell's remaining counterclaims."). Notwithstanding these broad statements, Novell later claims that the five day trial was really only going to address two things: "to apportion the funds SCO had [allegedly] wrongfully received and retained, as well as provide limited declaratory relief regarding SCO's authority to enter into certain licenses with third parties." *Id.* at p. 2.

[9] Novell mistakenly argues that if the automatic stay is lifted to permit it to complete the trial in the Novell Litigation, the "District Court will resolve all remaining issues." Motion at p. 12. This is not correct because even if that court apportioned part of the SCO Royalties as property belonging to Novell, that finding alone would not be sufficient to rule that SCO Group's cash is encumbered by a constructive trust. What is missing from the issues scheduled to be tried in the District Court was whether any of the SVRX Royalties are traceable to SCO Group's current cash, after four years of operations. As noted above, this was an issue that Novell, in its trial brief, expressly suggested be determined by the District Court in a separate hearing *after* the five day trial on royalties was conducted.

Krystal Cadillac Oldsmobile GMC Truck, Inc., 142 F.3d 631, 637 (3d Cir. 1998)("The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws.")(quoting H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 340 (1977)). The purposes for the imposition of an automatic stay include relieving the debtor "of the financial pressures that drove [it] into bankruptcy," *see Borman v. Raymark Indus., Inc.*, 946 F.2d 1031, 1033 (3d Cir. 1991)(quoting H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 340 (1977), protecting the bankruptcy estate from being whittled away by creditors' lawsuits, *see Maritime Elec. Co. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991), and implementing a system whereby all creditors will be treated equally. *University Med. Center v. Sullivan (In re Univ. Med. Center)*, 973 F.2d 1065, 1074 (3d Cir. 1992). Thus, the automatic stay does not simply serve to protect the debtor; it also protects the estate and its creditors. *See, e.g., Acands, Inc. v. Travelers Cas. and Sur. Co.*, 435 F.3d 252, 259 (3d Cir. 2006)("the automatic stay serves the interests of both debtors and creditors"); *Krystal Cadillac*, 142 F.3d at 637 ("The automatic stay also provides creditor protection")(citation omitted); *Maritime Elec. Co.*, 959 F.2d at 1204 ("the automatic stay serves the interests of both debtors and creditors").

B. Cause for Granting Stay Relief Does Not Exist

Novell seeks relief pursuant to § 362(d)(1), which provides as follows:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay –
>
> (1) for cause, including lack of adequate protection of an interest in property or such party in interest[.]

11 U.S.C. § 362(d)(1). Other than the one example provided, *i.e.*, a lack of adequate protection, the Bankruptcy Code does not define "cause" for relief from the stay. Although the Third Circuit has not spoken on the issue, the District Court for the District of Delaware identified the following considerations when evaluating a stay relief motion based upon "cause":

> [I]n resolving motions for relief for "cause" from the automatic stay courts generally consider the policies underlying the automatic stay in addition to the competing interests of the debtor and the movant. In balancing the competing interests of the debtor and the movant, Courts consider three factors: (1) the prejudice that would be suffered should the stay be lifted; (2) the balance of the hardships facing the parties; and (3) the probable success on the merits if the stay is lifted.

In re Continental Airlines, Inc., 152 B.R. 420, 424 (D. Del. 1993), citing *Int'l Business Machines v. Fernstrom Storage & Van Co. (In re Fernstrom Storage & Van Co.)*, 938 F.2d 731, 734-37 (7th Cir. 1991).[10] When each of the purposes of the automatic stay are examined, and considered in conjunction with the three competing factors identified in *Continental Airlines*, it is clear that the Motion should be denied and the automatic stay should remain intact.[11]

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[10] Novell recognizes that the *Continental Airlines*' analysis applies with respect to the relief it seeks. *See* Motion at p. 9. Notwithstanding that acknowledgement, Novell then spends a great deal of its Motion going through twelve different factors that the Second Circuit identified in *Sonnax Indus., Inc. v. Tri Component Prods. Corp.*, 907 F.2d 1280 (2nd Cir. 1990). The Debtors submit that the Court need not examine each and every one of the *Sonnax* factors when addressing the Motion as the application of *Contintental Airlines* addresses the majority of them anyway. Regardless, even an examination of the *Sonnax* factors supports the Debtors' position that the Motion should be denied.

[11] A preliminary issue is whether Novell has the burden of proving that cause exists or whether the Debtors have the burden of proving that it does not. The Bankruptcy Code is only somewhat helpful on this point, as § 362(g) provides that the party seeking relief has the burden of proof on the question of the debtor's equity in the property, and the party opposing the relief has the burden on all other issues. However, notwithstanding the vague and ambiguous statements set forth in footnote 2 of the Motion, Novell does not appear to be seeking stay relief based upon a lack of equity in property of the estate. It is for that reason that courts typically apply a mixed burden when stay relief is sought for cause that is unrelated to a lack of adequate protection. *See, e.g., In re Sonnax Indus, Inc.*, 907 F.2d at 1285 ("[s]ection 362(d)(1) requires and initial showing of cause by the movant . . . . If the movant fails to make an initial showing of cause, however, the should deny relief without requiring any showing from the debtor that is entitled to continued protection."). For that reason, a "[f]ailure to prove a prima facie case requires denial of the requested relief." *See In re RNI Wind Down Corp.*, 348 B.R. 286 (Bankr. D. Del. 2006)(citing *Sonnax*). Here, even assuming the Court were to conclude that Novell made a prima facie showing of cause, as set forth herein, the Debtors have shown, or will show, why they, the estate, and the creditors are entitled to the continued protection of the stay.

1. Prejudice to SCO's Estate If the Stay is Lifted

The first factor to examine is the prejudice to SCO's estate if the stay is lifted. Unlike in the *Continental Airlines*' case, Novell is not seeking to have the stay lifted so that it can proceed forward with a discrete motion in already pending litigation. Rather, it is seeking to have relief from the automatic stay to go forward with a full blown, five-day trial to obtain damages of up to $37 million (more than the Debtor's total assets), and then to impose a constructive trust over most, if not all, of the Debtor's cash. Although the language in the Motion is intentionally vague with respect to the constructive trust issue, at its core, Novell's Motion seeks to have the District Court determine what part of the Debtor's bank accounts is or is not property of the estate.

Imposing such a constructive trust in the amount Novell seeks, on funds that are presently property of the estate and in the possession of the Debtors, would effectively kill this Chapter 11 case at its very inception. Many authorities and even one of the cases relied upon by Novell in its Motion, show that when the bankruptcy case's administration will be impacted in such a fashion, a motion for stay relief to proceed with litigation in another forum should ordinarily be denied if the bankruptcy case's administration will be impacted in such a fashion. *See In re W.R. Grace & Co.*, 2007 WL 1129170, *2 (Bankr. D. Del. April 13, 2007)("The most important factor in determining whether to grant stay relief from the automatic stay to permit litigation to proceed against a debtor in another forum is the effect on such on the administration of the estate. Even slight interference with the administration may be enough to preclude relief

in the absence of a commensurate benefit.")(quoting *In re Curtis*, 40 B.R. 795, 806 (Bankr. D. Utah 1984)).

Moreover, if the Motion were granted and the Utah District Court proceeds with "bet the Company" litigation, the attention of the Debtors and their top management would have to be riveted to that case, to the detriment and exclusion of their reorganization efforts at this critical juncture in the bankruptcy case. In fact, just today, the Debtors filed their *Emergency Motion Of The Debtors For An Order (A) Approving Asset Purchase Agreement, (B) Establishing Sale And Bidding Procedures, And (C) Approving The Form And Manner Of Notice Of Sale* (the "Sale Procedures Motion"). The transaction that the Sale Procedures Motion contemplates will provide the framework and foundation for the Debtors' plan of reorganization. The efforts of management should be focused on that sale, and a plan, rather than on litigation that can be addressed at a later date. The prejudice in granting stay relief to allow critical, large-scale litigation to proceed in another forum is both evident and overwhelming.

2. Balancing of Hardships Warrants Continuation of Stay

When balancing the hardships to Novell, the Debtors, and the other creditors, it is clear that the stay should remain intact. If the automatic stay remains intact, Novell is not going to be in any different position than it is right now. The issues being raised by Novell, with the exception of those relating to the constructive trust it seeks, can be decided post-confirmation. This is especially true in light of the Sale Procedures Motion, which contemplates the sale of the SCO Unix Business. The Debtors are not saying that issues raised by Novell in the Utah District Court case do not need to be addressed at some point in order to determine the validity and

amount, if any, of Novell's alleged claim. Rather, they simply do not need to be addressed on any rushed basis in another forum at this time.

This Court has presided over many cases in which heated litigation is stayed throughout the reorganization process. In such cases, determination of whether a claim exists and if so, in what amount, is deferred until after confirmation, with the plan of reorganization providing alternative dispositions of claims and interests dependent upon the result of post-confirmation litigation. *See, e.g., Three A's Holdings, LLC; Case No. 06-10886-BLS (D.E. #1565, order confirming plan entered August 6, 2007). See also In re Northwest Airlines Corp., Case No. 05-17930-ALG (D.E. #6944, order confirming plan entered May 18, 2007).* And, of course, many if not most chapter 11 plans are confirmed prior to completion of the claims resolution process.

In the recently concluded Northwest Airlines bankruptcy case, the court repeatedly refused to grant relief from stay to various parties who sought to conclude litigation on the verge of trial in the courts in which they were pending. In one such ruling, Judge Gropper denied a motion by a group of plaintiffs who were seeking to commence a trial of their antitrust lawsuit before the United States District Court for the Eastern District of Michigan. *In re Northwest Airlines Corp.*, 46 B.C.D. 39; 2006 WL 687163 (Bankr. S.D.N.Y., March 10, 2006). The issue in that case really could have been viewed as essential to confirmation issues because it was the creditors' view that the debtor's mode of operation – the hub and spoke model, at least as operated by Northwest – perpetrated violations of the antitrust laws. If that same system were the basis for Northwest's post-bankruptcy operations, one could argue that the plan was neither

feasible nor in conformity with law, both confirmation issues. As the creditors put it, the lawsuit "seeks to permanently enjoin the core of Northwest's business model and would affect its reorganization." *See Movants' Reply Brief in Support of Motion for Stay Relief to Proceed with Antitrust Class Action Litigation*, D.E. 2019, filed February 9, 2006 (*In re Northwest Airlines Corp., #05-17930-ALG).* Nevertheless, the court said that "[t]he impact of the stay and a balancing of the equities weigh strongly in favor of denial of the Motion." *Northwest Airlines,* at *2.

The factors credited by the *Northwest Airlines* court in denying the motion were that:

(1) The debtors were at a critical stage of their reorganization cases (even though the plan wasn't filed for another six months);

(2) The fact that trial may have been imminent in the district court weighed *against* granting the motion because it would take management attention away from reorganization issues to defend large-scale litigation;

(3) The creditors had "not shown any unusual prejudice by a continuation of the stay"; and

(4) There was "no issue of public health or safety and no indication that the Movants' claims must be resolved before the Debtors can file a feasible plan." *Id.*

Those very same points exist here. The Debtors are at a critical stage of their reorganization cases. Pending within days will be a motion to approve, among other things, a

sale of the Unix assets and to approve a line of credit for the Debtors' future litigation financing needs. That sale, per the Term Sheet filed with the Sale Procedures Motion, requires a closing by December 31, 2007. The Debtors seek approval of the sale motion as a predicate to the filing of a plan within the exclusivity deadline of January 12, 2008. The transactions contemplated by the Term Sheet will require the full attention of management on finalizing the transaction. These duties include the immediate tasks of negotiating and executing definitive agreements with the prospective purchaser (including preparing related disclosure schedules), dealing with the demands of other prospective bidders for due diligence and assisting counsel in both the transaction and with the bankruptcy case itself. And once the transaction closes, management's time will be tightly focused in crafting and then assisting counsel in drafting a plan of reorganization and accompanying disclosure statement by the close-approaching deadline.

Dropping everything at this juncture to start a five-day trial to resolve most, but not all, issues allegedly important to Novell is nothing but a wasteful distraction from the issues that affect the entire estate and are essential to any reorganization case.

The burden to show harm is on the movant. It is the movant that "bear[s] the heavy and possibly insurmountable burden of proving that the balance of hardships tips significantly in favor of granting relief as against the hardships to the debtor in denying relief." *In re Micro Design, Inc.*, 120 B.R. 363, 369 (E.D. Pa. 1990). Other than opining, erroneously, that its issues *must* be decided before reorganization can occur, Novell has stated no argument as to why it would be unusually prejudiced by waiting a few more months to progress a case that has already been pending for years.

Nor, in this case, is there any issue of public health or safety necessitating immediate trial in a distant court before a plan of reorganization can be proposed.

This Court should, therefore, follow the lead of the *Northwest Airlines* court and deny the Motion.

3. Probability of Success on the Merits

While Novell has, subject to appeal, prevailed in the District Court on how the Asset Purchase Agreement defines an SVRX Royalty, there is nothing in that decision or anything else that Novell has shown, that establishes that Novell is likely to prevail with respect to how much of the Sun and Microsoft monies, or SCOSource monies, should be attributed as an SVRX royalty. It is SCO's position that none or a *de minimus* amount of these funds are related to the older SVRX products. SCO contends that these 2003 Microsoft and Sun agreements included a license to the older versions of System V code only because these licensees wanted to make sure that their licenses were inclusive but that the pricing and economic value of the royalties were for the more current Unixware source-code licenses.

Nor has Novell established that it is likely to prevail on its contention that any particular amount of funds held by SCO are properly traceable to these 2003 payments and subject to the imposition of a constructive trust. On the contrary, in unsuccessfully urging the District Court to enter an injunction in late 2006, Novell conceded that it could not establish a constructive trust position after SCO's bankruptcy:

> For SCO, bankruptcy is inevitable; it characterizes its assets as merely those "remaining" and does not rebut Novell's arguments that its bankruptcy is imminent. (Citation omitted). Once this bankruptcy occurs, Novell will lose its ability to collect its judgment. *See In re PKR, P.C.*, 220 B.R. 114, 117 (B.A.P. 10th Cir. 1998)("constructive trusts are not recognized or imposed in bankruptcy

> proceedings unless the trust was imposed either statutorily or judicially prior to the bankruptcy").

Novell's January 9, 2007 Redacted Reply to SCO's Opposition to Novell's Motion for Partial Summary Judgment or Preliminary Injunction, p. 15 (the "Novell Reply"). The Debtors agree with that position, and Novell should not be allowed to reverse field on the point now that the injunction was denied and SCO has filed for protection under the bankruptcy laws.

Novell has made no showing that it is likely to succeed on the merits on the imposition of a constructive trust upon any of SCO's currently held funds traceable to the 2003 payments based upon the application of the Lowest Intermediate Balance Test ("LIBT"). *See, e.g., In re Columbia Gas Systems, Inc.*, 997 F.2d 1029, 1063-64 (3d Cir. 1993)(court adopted use of the LIBT in determining how much, if any, of commingled funds were presently held in trust); [12] *City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 102 (3d Cir. 1994)(court pointed out the need for bankruptcy court and district court to make factual findings when applying the LIBT). Moreover, as set forth below, the lowest intermediate balance determination must be made by this Court, the one that has exclusive jurisdiction over property of the estate.

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[12] The Third Circuit described the LIBT method of tracing in this way:

> When a trustee commingles trust funds with other monies in a single account, the lowest intermediate balance rule aids beneficiaries in tracing trust property. *See* 4 L. King, *Collier on Bankruptcy* ¶ 541.13, at 79-80 (1993); 5 A.W. Scott & W.F. Fratcher, *The Law of Trusts* § 518, at 634-36 (4th ed. 1989); *Restatement (Second) of Trusts* § 202 cmt. J (1959). The lowest intermediate balance sheet rule, a legal construct, allows trust beneficiaries to assume that trust funds are withdrawn last from a commingled account. Once trust money is removed, however, it is not replenished by subsequent deposits. Therefore, the lowest intermediate balance in a commingled account represents trust funds that have never been dissipated and which are reasonably identifiable.

In re Columbia Gas Systems, Inc., 997 F.2d at 1063-64

4. Policies Underlying the Automatic Stay

The need to maintain the automatic stay in these cases is clearest when the policies underlying the stay are examined. Again, the automatic stay is not imposed simply to protect the debtor; it also exists to protect the creditors of the estate. Nowhere in the Motion does Novell take into account the interests of any creditors (other than Novell) in the outcome of the Utah District Court litigation. Congress's jurisdictional grant to the district courts (and through the general reference from the district courts to the bankruptcy courts) provides a single forum where *all* creditors can be treated equally *and* have a right to be heard. In the Utah District Court litigation, the Debtors' creditors will not be heard because they are not parties. Instead, that action is a vehicle for Novell to seek to establish whatever rights it has above those of all other creditors of the estate.

In fact, part of the relief that Novell seeks in the lawsuit – the imposition of a constructive trust – is a form of relief that strikes at the very heart of a bankruptcy case: it is aimed directly at a determination as to what is or is not property of the estate. As stated by the Second Circuit just two weeks ago:

> As discussed above, the effect of a constructive trust in bankruptcy is to take the property out of the debtor's estate and to place the constructive trust claimant ahead of other creditors with respect to the trust res. 11 U.S.C. § 541(a)(1), (d) . . . . *It is therefore not the debtor who generally bears the burden of a constructive trust in bankruptcy, but the debtor's general creditors. This type of privileging of one unsecured claim over another clearly thwarts the principle of ratable distribution underlying the Bankruptcy Code. As a consequence bankruptcy courts have been reluctant, absent a compelling reason, to impose a constructive trust on the property in the estate.* [Citations omitted; emphasis added].

In re Flanagan, ___ F.3d ____, 2007 WL 2915812, *8 (2nd Cir. Oct. 9, 2007). It is beyond cavil that this Court has the exclusive jurisdiction over the estate and estate property. *See* 28 U.S.C.

§1334(e)(district court in which a bankruptcy case is filed "shall have exclusive jurisdiction . . . (1) of all property, wherever located of the debtor as of the commencement of such case, and of property of the estate. . . ."). This Court should, therefore, make any determinations as to what is or is not property of the estate, and *if* a constructive trust can be imposed,[13] and in what amount.[14] *See, e.g., In re Continental Airlines*, 138 B.R. 442, 445 (D. Del. 1992)("'The determination of what constitutes property of the estate is inherently an issue to be determined by the bankruptcy court.'")(quoting *In re Fisher*, 67 B.R. 666, 668 (Bankr. D. Colo. 1986); *In re All American Laundry Service*, 128 B.R. 639, 643 (Bankr. N.D. Ill. 1991)("a determination of what is property of the estate, and concurrently, of what is available for distribution to creditors of the estate, is precisely the type of proceeding over which the bankruptcy court has exclusive jurisdiction"); 28 U.S.C. § 157(b)(2)(A) and (O); *In re DVI, Inc.,* 306 B.R. 496 (Bankr. D. Del. 2004)(denying creditor's motion to lift stay to let Illinois federal district court decide whether assets of the estate were encumbered by constructive trust).

Novell's argument that the estate will not be harmed in any way by the granting of stay relief is remarkable because Novell seeks imposition of a constructive trust over most, or ALL of the Debtor's cash reserves, without affording any other creditors any right to be heard or to participate in that crucial determination. Indeed, for this reason alone, Novell's reference to

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[13] Again, the Debtors agree with Novell's admission in the Novell Reply that once a bankruptcy is filed, it is not entitled to the imposition of a constructive trust. Respectfully, in light of its previous arguments in the Novell Litigation, Novell should be estopped from arguing to the contrary now.

[14] Bankruptcy courts are frequently required to engage in tracing analysis and, accordingly, are better equipped to deal with such issues than district courts. *See, e.g., Columbia Gas, supra; First Federal of Michigan v. Barrow*, 878 F.2d 912 (6th Cir. 1989); *In re Wood*, 2007 WL 2154239 (Bankr. N.D. Tex., July 25, 2007); *In re Jackson*, 318 B.R. 5 (Bankr. D. N.H. 2004); *Old Republic Nat'l Title Ins. Co. v. Tyler (In re Dameron)*, 206 B.R. 394, 403 (Bankr. E.D. Va. 1997). *See generally* 5 *Collier on Bankruptcy,* ¶ 5-541, at 541.11 (15th ed. rev. 2007).

certain legislative history in support of its argument that it is "often" more appropriate to allow litigation to proceed forward in their place of origin "when no great prejudice to the bankruptcy estate would result," actually supports the Court's denying the Motion. *See* Motion at p. 8. In this case, allowing the Utah District Court to impose a constructive trust on the Debtor's cash would effectively terminate these bankruptcy cases, with extreme prejudice.

Moreover, the financial pressures that led to the filing of these bankruptcy cases will be exacerbated by granting Novell stay relief at this time, when the Debtors need to devote their resources to finalizing and effectuating the sale of certain assets and to developing a plan that addresses the claims of *all* of the Debtors' creditors and preserves the right to seek judicial review of the summary judgment rulings that adversely affects the estate's valuable intellectual property rights.[15] There will come a time when it will be appropriate for the Utah District Court

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[15] In the Motion, Novell reserved the right to argue that these bankruptcy cases were filed in bad faith. *See* Motion at p. 3, n. 1. Respectfully, Novell did not raise bad faith as a basis for stay relief because it knows any such argument is completely baseless. Specifically, Novell has made repeated statements in the Novell litigation as to the financial predicament in which SCO finds itself:

> Furthermore, by SCO's own admission, its financial picture will continue to darken. With its UNIX revenues rapidly declining, SCO has tied its financial future to its ability to prevail in the IBM Litigation. [Citation omitted]. SCO recently suffered a substantial loss in the IBM Litigation when two-thirds of its case was dismissed. Moreover, notwithstanding SCO's infusion of $5,000,000 of additional cash into an escrow account to cover SCO Litigation costs and expenses on June 5, 2006, only $1,561,000 remained in that escrow account as restricted cash for the Litigation as of the end of July 2006. [Citation omitted]. Indeed, just two months ago, SCO admitted that it burns through the remaining restricted cash for the SCO Litigation (a likely scenario given the intensive ongoing proceedings in the IBM Litigation), which it is already doing, it "may be required to place additional amounts into the escrow account, which could harm our liquidity position." [Citation omitted]. *Thus, with a fast-growing burn rate and limited cash, SCO is trapped in a financial tailspin from which it cannot escape.*

September 29, 2006 Memorandum in Support of Novell, Inc.'s Motion for Partial Summary Judgment or Preliminary Injunction, p.33. (Emphasis added). Indeed, in the Novell Reply, in light of SCO's financial condition, Novell characterized SCO's bankruptcy filing as not only "imminent," but also, as "inevitable." And, if that were not enough, the status of SCO's financial condition continues to be an issue that is recognized by Novell. *See* Motion at p. 8 ("Moreover, given the role of . . . SCO's business model and already historically marginal financial affairs . . . ."). Clearly, the filing of these bankruptcy cases was not made in bad faith and the Debtors take exception to Novell's insinuation to the contrary.

to proceed to calculate the SVRX Royalty (although not the constructive trust issues, as to which the District Court has no prior involvement or special expertise and which are core to the Bankruptcy Court's jurisdiction and expertise). That time, however, should await the Debtors' a proposal of a plan of reorganization in the next few months which will provide a route for resolution of all creditor claims, including but not limited to, those that are the subject of pending litigation, in an orderly fashion.

[Remainder of page intentionally left blank.]

Conclusion

For all of the foregoing reasons, the Debtors respectfully request the Court to deny the Motion, and grant the Debtors such other and further relief as this Court deems just and proper.

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