UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	
	)	Chapter 11
The SCO Group, Inc., et al.,	)	
	)	Case No. 07-11337 (KG)
Debtors.	)	(Jointly Administered)

NOVELL, INC.'S REPLY TO DEBTORS' RESPONSE TO 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.

In its Memorandum of Law in Response to the Motion (the "Response"), SCO concedes that the District Court is the appropriate forum for the majority of the issues that remain between SCO and Novell, including apportionment of Novell's claims and determination as to the declaratory relief Novell seeks.[1] Thus, the thrust of the Response can be simplified into two disputed issues – the forum for determination of Novell's constructive trust and the appropriate timing for liquidation of Novell's claims. Despite SCO's contentions, an analysis of both issues supports lifting the automatic stay to allow the District Court Action to conclude.[2]

The first issue is the appropriate forum for determining Novell's constructive trust over what Novell asserts is its property that is being held by SCO. As the Court will see, SCO's opposition to stay relief is an attempt to forum shop. After four years of litigation, the District Court issued a decision favoring Novell's position over SCO's. It found that Novell was entitled

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1 "[I]n 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." (Response at p. 2.)

2 Capitalized terms used but not otherwise defined herein have the meaning ascribed to them in 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 "Motion").

to a constructive trust over certain property in SCO's control because that property belongs to Novell. Now, based on wholly inapposite case law, SCO argues that this Court should ignore the District Court Order and determine for itself *whether* Novell is entitled to a constructive trust and, if so, the application of that trust. This Court should not permit SCO to use this case to unwind what the District Court determined after both parties had an ample opportunity to fully and fairly litigate it. Moreover, given the advanced stage of litigation, the automatic stay should be lifted to allow Novell to have its remaining claims (including the *amount* of the constructive trust the District Court has already ruled will be proper) determined through completion of the District Court Action.

The second issue of controversy in the Response is *when* Novell's claim should be determined. SCO argues that there is no pressing need for Novell or the estates to determine and liquidate Novell's remaining claims at this juncture and that to allow the District Court Action to proceed would distract the Debtors from reorganization. Contrary to what SCO urges, however, there is a pressing need for Novell's remaining claims to be finalized, both for Novell and for the Debtors' estates. The District Court Action is ready for trial and its outcome will have a dramatic impact on Novell's business and reputation in the software community. A large contingent of the software community is also awaiting the outcome of the District Court Action, from a business perspective and otherwise.[3] Just as importantly, as SCO noted in its Response, SCO has brought an Emergency Motion for 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 Motion") of substantially all of its assets, including the Unix Business (as defined in the Sale Motion). Though the exact substance of the proposed sale is unclear

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[3] There have been thousands of pages of hard copy and online press covering this litigation. As an example of the level of interest the software community, at large, has in reaching final determination in the District Court Action, see www.groklaw.net, where there are over 2,500 entries tracking the progress of the District Court Action and SCO's related litigation.

because SCO did not file an asset purchase agreement with the Sale Motion (only a term sheet), the Sale Motion implies that SCO will attempt to sell assets that the District Court has held belong to Novell. SCO cannot sell what it does not own, and courts have held that ownership disputes must be resolved before a debtor tries to sell an asset. Thus, SCO's own agenda in this case means that Novell's claims must be timely decided in order for SCO to proceed with its attempt at reorganization (whether through the Sale Motion, a plan of reorganization, or otherwise).

Accordingly, Novell's request that the automatic stay be lifted to complete the District Court Action should be granted.

The District Court Action Should Be Concluded in the District Court

The issues in the District Court Action, including the constructive trust, should be concluded in the District Court for all of the reasons stated in the Motion, including the four year history of litigation and the entry of the District Court Order that determined the majority of issues between the parties. The only remaining issues are those that would have been decided by the five-day trial on apportionment and points of declaratory judgment and those issues stayed pending a ruling from the Swiss arbitration (which SCO also hopes to delay).

In general, SCO does not contest the proposition that the District Court should complete the litigation, including apportionment of Novell's claim and determination of the declaratory relief Novell seeks. In not contesting these points, SCO implicitly recognizes the four-year litigation history in that forum, the law of the case, and the import of the District Court Order on a final resolution of the issues between the parties.[4] Nevertheless, SCO argues that this Court

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[4] It is also important to note that, procedurally, Novell must be awarded an apportionment of the funds in dispute before any court can determine the amount over which Novell may have a constructive trust. SCO, of course, disputes that Novell is entitled to more than a *de minimus* apportionment. (Response at p. 16.) Relief from the automatic stay is, thus, further merited as SCO does not contest that Novell's claim should be apportioned before the District Court – a necessary prerequisite to determination of any constructive trust. Further, SCO asserts that

should determine the amount of Novell's constructive trust. After acknowledging that the District Court should determine the amount of apportionment, one would think having the same court determine the constructive trust would follow as a matter of course. SCO's briefing makes clear its aim, however. In the course of its opposition, SCO transforms the issue of the *amount* of the constructive trust into *whether* there is a constructive trust – a completely different question.[5] SCO asserts that this Court should decide the latter question because of the alleged interests of the estate in the funds that would be subject to the trust and, supposedly, the interest other creditors may have in those funds. (It is noteworthy that no other parties-in-interest, including the U.S. Trustee, have objected to the Motion.) This subtle but momentous shift in the issues is where SCO goes too far, evidenced by SCO's virtually exclusive focus on the purported principle that bankruptcy courts should impose constructive trusts only begrudgingly because of the effect of such a trust on other creditors.

In support of its contention that this Court should second guess the District Court on whether a constructive trust is appropriate, SCO misleadingly relies on *In re Flanagan*, 2007 WL 2915812 (2d Cir. 2007). Though the court did decline to impose a constructive trust in *Flanagan*, there is a distinguishing factor from the facts at hand. In *Flanagan*, a creditor obtained a judgment against the debtor. The debtor then fraudulently hid its ownership in an unrelated company from the creditor so that the creditor could not attach the stock in satisfaction of the judgment. The creditor – who had no interest in the stock apart from its general right to attach the debtor's assets, and, in particular, made no claim that its own property could be traced into the affiliated company – sought a constructive trust over the debtor's stock. The court held

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even if Novell is successful in receiving a meaningful apportionment of the disputed funds and is successful in establishing a constructive trust, Novell will not be able to trace the funds in order to establish a trust. Thus, SCO's position that Novell will "kill this Chapter 11 case at its very inception" is inconsistent and reveals its true motivation – forum shopping. (Response at p. 11.)

that it could not impose a constructive trust in favor of the creditor because the debtor was now in bankruptcy and to do so would take money from general creditors rather than undoing an unjust enrichment of the debtors. The creditor was "never entitled to an ownership interest in the...stock. Rather, under Connecticut's post-judgment remedy statute, the turnover order only entitled appellants to gain possession of the stock as the first of several steps in executing a levy upon it." *Id.* at *7. Plainly stated, the creditor had no prior ownership or interest in the asset over which it sought the constructive trust.

In this case, by contrast, with respect to the property over which Novell seeks a constructive trust, the District Court has already held that there is a *res* belonging to Novell. "In this case, the res is the SVRX Royalties, to which Novell retains all right, title, and interest. This res is traceable to the monies [that SCO] received from the Sun and Microsoft Agreements. SCO's conduct also amounts to a breach of fiduciary duty, conversion, unjust enrichment, and breach of express contract, all of which are sufficient wrongful conduct to impose a constructive trust." (District Court Order at 97, internal quotations omitted.) In short, unlike in *Flanagan*, at issue in the District Court Action now is not *whether* Novell is entitled to a constructive trust, but only the *amount* of the trust. SCO should not be allowed to re-litigate the issue of whether there should be a Novell constructive trust before another court under the guise of determining how much is in the trust simply because it did not like the outcome of a litigation it chose to initiate and had a full and fair opportunity to litigate.[6]

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[5] The Debtors argue that "[t]his 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, and in what amount." (Response at p. 19 (emphasis in original)).

[6] SCO's argument that Novell is estopped from asserting a constructive trust in face of SCO's chapter 11 cases based on an argument Novell made in a brief before the District Court is also misplaced. (Response at 16-17.) The section of Novell's brief that SCO references was submitted before entry of the District Court Order, which recognized that the elements for a constructive trust were present. Further, given the forum and timing, the quoted language did not contemplate that Novell may seek and receive relief from the automatic stay to enforce its rights.

In summary, Novell seeks to allow the District Court Action to conclude so that Novell's property can be returned to it through the allocation that was to occur by short trial in the District Court Action. As detailed in the Motion, these are precisely the circumstances under which courts have routinely lifted the automatic stay.

Novell's Claims Must Be Determined Promptly

It is in the interests of the estates and their creditors, including, of course, Novell, to liquidate Novell's claims as soon as possible in the District Court. Novell already has discussed this issue in the Motion. However, a recent development initiated by SCO adds further weight to Novell's position.

As the Court is aware, the Debtors have brought the Sale Motion, which seeks to sell substantially all of the Debtors' business, including the Unix Business. Though no asset purchase agreement has been filed that details the proposed transaction, Novell submits that it is unlikely that the transactions contemplated by the Sale Motion can close without determination of Novell's claim. For example, the Sale Motion contemplates sale of the "Linux Litigation" (as defined in the Sale Motion). The Linux Litigation is so intrinsic to the sale process that it accounts for a hypothetical $10 million of the purported $36 million purchase price. *Yet, the Linux Litigation is based on copyrights that the District Court has held belong to Novell.* Thus, the Debtors are seeking to sell assets that do not belong to them. This is not only imprudent, especially given that the lack of a definitive agreement prevents the community of interests in this case from determining what risks to the estate the sale may entail, but is also frowned upon by courts generally. *See In re Rodeo Canon Dev. Corp.*, 362 F.3d 603, 608 (9th Cir. 2004), *withdrawn per settlement*, 2005 U.S. App. LEXIS 3802 (9th Cir. 2005) (property could not be sold free and clear of liens, claims, and encumbrances when debtor's title was in dispute), *In re Clark*, 266 B.R. 163, 172 (9th Cir. B.A.P. 2001) (sale free and clear of claims denied because not property of the estate), *Gorka v. Joseph (In re Atl. Gulf Cmtys. Corp.)*, 326 B.R. 294 (D. Del.

2005) (sale of real property under section 363 not free and clear of claims because title in dispute), *In re Claywell*, 341 B.R. 396 (Bankr. D. Conn. 2006) (sale disallowed pending resolution of debtor's ownership in property).

Further, even if, hypothetically, the sale were revised to exclude the Linux Litigation, the Sale Motion implies that a sale of the Unix Business will include the Debtors' assumption and assignment of any executory portions of the APA between Novell and SCO to the buyer.[7] Of course, as a prerequisite to assumption of any contract, the Debtors must cure all defaults under that contract. Novell asserts that there are approximately $40 million in damages due to it under the APA due to SCO's breach, as detailed in ¶ 5 of the Declaration of David Melaugh, attached hereto as Exhibit "A" (the "Melaugh Declaration"). Though, again, the Debtors have not yet made an asset purchase agreement available, given the proposed purchase price detailed in the Sale Motion and the term sheet, if Novell's claims stand it is unlikely that the Debtors or a buyer would be able (or even willing) to cure the defaults under the APA and related agreements, even in the event they are otherwise eligible for assumption and assignment. Similarly, the District Court has ruled that SCO has infringed Novell's rights under the APA, including "breach of express contract." (District Court Order at p. 97.) Though it is unclear what representations and warranties the Debtors offer their buyer in the sale, the conflict between the Debtors' desire to close a sale imminently and their inability to do so without determining the impact of curing the defaults under the APA is illustrative of the need for the estates to have Novell's claims determined expeditiously.

The Debtors also argue that the completion of the District Court Action will distract its management from the sale process and formulation of a plan of reorganization. As Novell has just explained, without resolution of Novell's claims, the sale and reorganization process cannot

advance. Moreover, given the advanced stage of litigation, any "distraction" that management would face to complete the District Court Action would be minimal. Notably, the parties have: completed discovery, including all depositions; exchanged witness lists; exchanged exhibit lists; and exchanged stamped copies of the trial exhibits. (Melaugh Declaration at ¶ 3.) All that remains is the bench trial itself, which was to conclude in less than a week, once commenced.[8] The District Court's docket is busy and whatever minimal attention is required from the Debtors' management may not even occur immediately. However, if stay relief is not granted now, the process of trying to get the District Court Action finalized by appropriate means will be driven just that much further into the future. Given the importance of Novell's claims to the Debtors' estates, resolution of these issues is an important, though minimal, use of management's time, not a distraction, as purported by the Debtors. These issues should be addressed sooner rather than later.

As detailed above, resolution of Novell's claims is paramount to the estates and their creditors, but it is, of course, paramount to Novell directly as well. The public interest and the interests of Novell also favor stay relief now. Given the high-profile nature of the litigation and the profound interest of the software community in the matter, it is unjust to delay resolution of the District Court Action. Novell's Motion should be granted and the automatic stay should be lifted to allow the District Court Action to conclude.[9]

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[7] Novell does not concede that portions of the APA are executory and expressly reserves the right to object to any assumption and/or assignment on that, and any other, basis.

[8] The Debtors' assertion that the District Court Action and the facts at hand are analogous to a request for relief from the automatic stay by parties asserting infringement for Northwest Airlines' "hub and spoke" business model at a time when the Northwest debtors were renegotiating their labor contracts is absurd. (*See* Response at p. 14.) If there is an analogy to be made to SCO's estates, Novell's claims are as significant to the Debtors' reorganization as renegotiation of labor contracts are to an airline – they are not tangential in nature, as was the case in *Northwest*.

[9] Though the Debtors suggest otherwise (*see* Response at FN11), it bears repeating that the Debtors have the burden of proof to show that "cause" does not exist for stay relief to complete the District Court Action. *See* 11 U.S.C. § 362(g): "(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in

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property; and (2) the party opposing such relief has the burden of proof on all other issues." *See also In re Rexene Prods Co.*, 141 B.R. 574, 577 (Bankr. D. Del. 1992) ("in the determination of "cause," section 362(g) is interpreted as placing an initial burden on the moving party to establish its prima facie case which must then be rebutted by the party opposing such relief"). Novell submits that it has made a *prima facie* case that such "cause" exists, for the reasons outlined in detail in the Motion and in this Reply; it submits equally that SCO has not carried its burden.