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 IN SUPPORT OF MOTION FOR ORDER DIRECTING THE DEBTORS TO REMIT UNDISPUTED FUTURE SVRX ROYALTIES TO NOVELL UPON RECEIPT

1. In their opposing papers (the "Opposition"), the Debtors concede that the Undisputed Future SVRX Royalties belong to Novell, not the estate.[1] Thus, the only issue for the Bankruptcy Court to decide is when the Debtors should remit these royalties to Novell. For the reasons stated in the Motion and as set forth below, this Court should order the Debtors to do so immediately upon receipt.[2]

SCO Identifies No Prejudice from Motion.

2. In the Motion, Novell is asking for relief under section 105 of the Bankruptcy Code, which suggests that in deciding whether to grant that relief, this Court should balance the equities. SCO does not dispute, because it cannot, that it is in dire financial straits and that it may run low on or out of cash during the reorganization process. (Motion, ¶ 21.) Nor does

---

[1] Capitalized terms used but not otherwise defined in this Reply shall have the meanings ascribed to them in Novell, Inc.'s Motion for Order Directing the Debtors to Remit Undisputed Future SVRX Royalties to Novell upon Receipt [Docket # 90], dated October 4, 2007 (the "Motion").

[2] As SCO raises in an improper "supplemental" filing, both SCO and Novell mistakenly relied upon the language from the original APA in their briefing and declarations. The original APA contemplates quarterly remission of the Undisputed SVRX Royalties. Motion, ¶ 3; Opposition, p. 3. Amendment No. 1 to the APA, attached to this Reply as Exhibit A ("APA Amendment No. 1"), changed the remittance schedule from quarterly to monthly. APA Amendment No. 1, ¶ I(1). The basis for this motion remains unchanged, however: without immediate remittance to Novell, the Undisputed Future SVRX Royalties remain at risk in the Debtors' hands.

SCO forswear any intent to use the Undisputed Future SVRX Royalties to fund its ongoing operations. The only harm the Debtors can show is thus predicated on an improper use of Novell's property, which is forbidden by both the Bankruptcy Code and the APA. (Indeed, why oppose this motion if not to retain the ability to use the Undisputed Future SVRX Royalties?)

3. On the other hand, as Novell has shown, and as the Debtors have not contested, the Debtors could turn Novell into a forced lender if and to the extent they use Novell's property – liquid cash – to fund their operations while in bankruptcy. Contrary to SCO's Opposition, Novell has good reason to believe the Debtors will withhold SVRX royalties if it suits them. Though the Debtors claim they have never failed "to remit the required royalty payments in a timely fashion in the 12 years since the APA was executed" (Opposition, p. 4), this ignores, at least, the six month period in 2003 when SCO wrongfully withheld such royalties because of an imagined "breach" of the APA. *See, e.g.*, July 11, 2003 letter from Novell to SCO, and SCO's response, both of which are attached to this Reply as Exhibit B. And it ignores the fact that the District Court in Utah has held that, as a matter of law, SCO has wrongfully withheld additional royalties from Novell, in an amount to be determined.

4. Against the risk to Novell of the Debtors continuing to retain the Undisputed Future SVRX Royalties, the Debtors do not offer any palpable harm grant of the Motion poses, nor do they suggest an alternative way of protecting Novell's property. Because Novell is the only party that can be harmed here, the Court should find in favor of Novell.

The Relief Sought Does Not "Impose an *Ipso Facto* Clause" and Is in Furtherance of Section 541(d) of the Bankruptcy Code.

5. In their Opposition, the Debtors build up a "straw man" only to knock it down, gaining nothing in the process. As the Debtors recognize, the APA does not have an *ipso facto* provision, which is unsurprising given that bankruptcy courts cannot enforce them.[3] So what the Debtors do is invent a new provision that they say Novell is trying to insert into the APA, argue that it contravenes the intent of the Bankruptcy Code, and claim that this invented provision is therefore unenforceable.

6. To the contrary, Novell is not asking the Court to modify the APA. Rather, it is asking the Court to protect Novell's property rights, an objective that section 541(d) of the Bankruptcy Code itself contemplates. Given the propensity for debtors to burn through cash while in bankruptcy, Novell is simply asking this Court to award relief akin to what other courts have ordered in the past. Where a debtor holds only legal title to property and no equitable ownership, "the sole permissible administrative act of the trustee or debtor-in-possession is to pay over or endorse over the property to the beneficiary or beneficiaries." *In re Signal Hill-Liberia Ave. Ltd. P'ship*, 189 B.R. 648, 651 (Bankr. E.D. Va. 1995) (*quoting Mid-Atlantic Supply, Inc. v. Three Rivers Aluminum Co.*, 790 F.2d 1121, 1126 (4th Cir. 1986)) (quotation marks omitted). As stated in the Motion, Novell is the beneficiary (Motion, ¶ 20), and the role

[3] "Subsection (e) [of section 365] invalidates ipso facto or bankruptcy clauses. These clauses, protected under present law, automatically terminate the contract or lease, or permit the other contracting party to terminate the contract or lease, in the event of bankruptcy. This frequently hampers rehabilitation efforts. If the trustee may assume or assign the contract under the limitations imposed by the remainder of the section, the contract or lease may be utilized to assist in the debtor's rehabilitation or liquidation. The unenforceability of ipso facto or bankruptcy clauses proposed under this section will require the courts to be sensitive to the rights of the nondebtor party to executory contracts and unexpired leases." H.R. Rep. No. 95-595, 95th Congr., 1st Sess. 348-9 (1977); *See* Sen. Rep. No. 95-989, 95th Congr., 2d Sess. 59 (1978).

of the Debtors is to turn the Undisputed Future SVRX Royalties over to Novell.[4] Thus, the Debtors cannot use Novell's property to fund its operations while in bankruptcy, or to pay the Debtor's creditors, pre- or post-petition. *See, e.g., Universal Bonding Ins. Co. v. Gittens & Sprinkle Enters., Inc.*, 960 F.2d 366, 372 (3d. Cir. 1992) (applying section 541(d) and noting bankruptcy law prevents trustee from distributing property of others to creditors) (citation omitted). Accordingly, rather than subject these funds to improper use by the Debtors, which may divest Novell of its property rights altogether – at which point it will be too late – this Court should order the Debtors to remit the Undisputed Future SVRX Royalties directly to Novell upon receipt.

7. To deny the relief requested in the Motion solely on the basis that it is predicated in some respect on the Debtors' financial condition ignores the liquid nature of cash (as opposed to property in a warehouse or leased by a debtor), the intent of section 541(d) of the Bankruptcy Code, and the Court's broad powers under section 105.

Novell's Hands are Clean.

8. Finally, SCO claims that a supposed breach by Novell of the APA precludes the relief Novell seeks. Putting aside whether Novell breached the APA, which Novell contests, the point is entirely irrelevant to the current motion. Even under SCO's version of events, it has acquiesced to the payment arrangements it describes – whereby SCO withholds its 5% from the following month's payment – for over *four years*.

---

[4] Novell's interests would be protected if the Debtors deposited the Undisputed Future SVRX Royalties with a third-party escrow agent upon receipt, but only if as part of that arrangement, the escrow agent would then periodically forward the funds to Novell. However, that arrangement is needlessly inefficient in any event because instead of forwarding the royalties to the escrow agent first, the Debtors should simply forward them to Novell. Escrowing these amounts would also be inefficient because the amount at issue here is relatively small (perhaps $800,000 annually) to justify the fees for establishing and maintaining the escrow, an unnecessary and wasteful step.

9. The Debtors establish no link between Novell's alleged breach some years past and the relief they now seek to prevent, and cite no authority at all supporting their argument. The APA is governed by California law under which, "[t]he misconduct which brings the unclean hands doctrine into operation must relate directly to the transaction concerning which the complaint is made, *i.e.*, it must pertain to the very subject matter involved and affect the equitable relations between the litigants." *Fibreboard Paper Prods. Corp. v. East Bay Union of Machinists*, 227 Cal. App. 2d 675, 728 (Cal. Ct. App. 1964) ("relief is not denied because the plaintiff may have acted improperly in the past or because such prior misconduct may indirectly affect the problem before the court"). The misconduct must infect the cause of action before the court. *Id.* This is not the case here: the Motion seeks immediate remittance and the purported breach is over non-payment of administrative fees (which the Debtors admit were eventually paid via setoff). Thus, the "unclean hands" doctrine does not apply.

10. Furthermore, sustaining the Debtors under these circumstances would mean that "unclean hands" is a ground for denying any relief sought by any creditor from any debtor. Even if the alleged breach took place, the law of unclean hands is not so expansive under California law as to apply to the breach of contract the Debtors allege. *Dollar Sys, Inc. v. Avcar Leasing Sys, Inc.*, 890 F.2d 165, 173 (9th Cir. 1989); *see also Smithkline Beecham Pharm. Co. v. Merck*, 766 A.2d 442, 450 (Del. 2000) ("every breach of contract does not necessarily require the application of the unclean hands doctrine . . . "). If the alleged breach were so egregious as to warrant the use of an equitable doctrine, how is it that the Debtors have only made an issue of it four years later? Instead of bringing it to Novell's attention immediately, the Debtors long ago acquiesced in whatever Novell may have done in this regard.

11. In any event, the Debtors were first to breach the APA, which they did in late 2002 by failing to remit royalties as agreed. *See, e.g.*, Exhibit B. So by their own reasoning, they themselves are prevented from having equity favor them in the first instance. If they are not so prevented, then for the same reason, nor is Novell.

12. Apart from the undisputed fact that the APA does not provide for immediate remittance, which Novell has shown does not preclude the relief requested in the Motion, the Debtors have been unable to articulate why immediate remittance is improper under these circumstances. The Bankruptcy Court should disregard the Opposition and grant the Motion in all respects.

(remainder of page intentionally blank)

Dated: November 1, 2007
Wilmington, Delaware

YOUNG CONAWAY STARGATT & TAYLOR, LLP

/s/ Sean T. Greecher
James L. Patton (No. 2202)
Michael R. Nestor (No. 3526)
Sean T. Greecher (No. 4484)
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, Delaware 19899-0391
Telephone (302) 571-6600

-- and --

MORRISON & FOERSTER LLP
Michael A. Jacobs
Adam A. Lewis
425 Market Street
San Francisco, California 94105-2482
Telephone (415) 268-7000

-- and --

MORRISON & FOERSTER LLP
Larren M. Nashelsky
James J. DeCristofaro
1290 Avenue of the Americas
New York, New York 10104-0050
Telephone (212) 468-8000

Counsel for Novell, Inc.