IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	
The SCO GROUP, INC., et al.,	Chapter 11
Debtors.	Case No. 07-11337 (KG) (Jointly Administered)
	Hearing: November 6, 2007 at 11:00 a.m. **Re: Docket No. 149**

IBM'S OBJECTION TO DEBTOR'S EMERGENCY MOTION FOR AN ORDER (A) APPROVING ASSET PURCHASE AGREEMENT, (B) ESTABLISHING SALE AND BIDDING PROCEDURES, AND (C) APPROVING THE FORM AND MANNER OF THE NOTICE OF SALE

International Business Machines Corporation ("IBM"), a creditor in this Chapter 11 case, objects to the "Emergency Motion For An Order (A) Approving Asset Purchase Agreement, (B) Establishing Sale And Bidding Procedures And (C) Approving The Form And Manner Of The Notice Of Sale," filed with this Court by the debtor and debtor in possession, The SCO Group, Inc. ("SCO" or "debtor"), on October 23, 2007.

Preliminary Statement[1]

At the First Day Hearing in this case on September 18, 2007, SCO told this Court:

- "SCO filed these cases to stabilize its business … to have its breathing spell";
- "this company looks to reorganize" with its mobility products and "the Unix software business that is, has been the foundation of the company";
- "SCO owes a heavy responsibility to its customers";

[1] References to SCO's Motion are given as "Mot. ¶ __". References to IBM's Objection are given as "Obj. at __". References to SCO's asset sale Term Sheet are given as "Term Sheet at __".

- "management and the Board are working on business solutions having nothing to do with this litigation";
- SCO looks forward "to coming to this Court with a plan of reorganization ... [that] will lead to an overall resolution, a business resolution of our disputes in the context of an overall plan of reorganization"; and
- "we intend to keep the lines of communication open with our friends on the other side of the courtroom, and others as well." (Transcript of First Day Hearing at 8-10 (D.I. 59).)

Yet, SCO has now filed, with virtually no prior communication and barely any supporting information, an Emergency Motion (the "Motion") to sell the "foundation of the company". Despite SCO's "heavy responsibility to its customers", the sale would hand its customers to a financial investor with no apparent operating system experience. Even worse, the transaction appears specifically designed to facilitate and promote, not resolve, the pending litigation.

The Motion and attached documents do not answer the most basic questions about SCO's proposed asset sale: whether there is an emergency or a need to sell these assets; what assets are actually included in the sale; whether this is the right buyer; whether this is the right price; or whether this is the right procedure. The burden should not be on creditors or this Court to search for the facts and justifications for a sale. Rather, SCO must set forth this and other required information before even bid procedures may be approved. In addition, the sale itself is flawed. As discussed more fully below, SCO's Motion therefore fails at two levels:

First, SCO'S Motion, proposed bidding procedures, and sale notice are all deficient in themselves and should not be approved. SCO has not provided any information supporting its proposed asset sale or the proposed bidder protections, any information describing the sale process in which it has already engaged or in which it proposes to engage leading to the auction, or any information on the proposed purchaser's qualifications or connections to SCO. (See Section I.A below.) Moreover, the bidder protections (fee and overbid amounts) are based on a

misleading characterization of the purchase price. (See Section I.B below.) In addition, SCO's proposed sale notice fails to identify the intellectual property, the executory contracts, or the litigation rights being sold, and it mischaracterizes the purchase price. (See Section I.C below.)

Second, this Court should not approve a bid-procedures motion where, as here, the proposed underlying sale is improper and itself cannot be approved. SCO proposes to sell assets that it does not own. Any such sale is improper. (See Section II.A below.) SCO proposes to borrow $10 million as part of the sale, but the borrowing must be considered under the separate standards and procedures of section 364 of the Bankruptcy Code. (See Section II.B below.) Finally, SCO does not provide any evidence why the asset sale is a sound exercise of business judgment, any explanation or justification for the haste in which SCO has entered into a sale of substantially all of its assets, any evaluation of how selling a substantial portion of its assets and entering into a loan with post-confirmation repayment terms will affect any future Chapter 11 plan, or any valuation of the assets being sold. (See Section II.C below.)

IBM respectfully submits that this Court therefore should deny the Motion and, at the very least, direct SCO not to bring a sale motion to this Court until it has established and followed proper procedures and provided full disclosure.

Background Facts

The facts on which this Objection is based include: (1) SCO's litigation campaign against computer software industry participants, including IBM and Novell, Inc. ("Novell"); and (2) SCO's proposed (free and clear) sale of its Unix Business, including assets at issue in SCO's litigations with IBM and others.[2]

A. SCO's Litigations.

In early 2003, SCO attempted to profit from the Unix and Linux operating systems by, among other things, embarking on a far-reaching publicity campaign to create the false and unsubstantiated impression that SCO had rights to the Unix and Linux operating systems that it does not have and by bringing baseless legal claims against IBM, Novell and others.[3]

While SCO filed lawsuits across the country, most of the litigation relating to SCO's claims and the numerous counterclaims asserted against it have been litigated in the U.S. District Court for the District of Utah, where SCO has its principal place of business. SCO sued both IBM and Novell in Utah, where the parties have been litigating separate cases before the same U.S. District Judge (Dale A. Kimball) and the same U.S. Magistrate Judge (Brooke C. Wells) for more than four years.

SCO's cases against IBM and Novell concern a host of complex intellectual property and other issues relating to the Unix assets SCO purports to sell, such as who owns the copyrights to

[2] IBM does not intend by this description to start or engage in litigation here of matters that have been long pending in the U.S. District Court for the District of Utah. Indeed, IBM believes that because of the extensive record already before the Utah District Court and that court's familiarity with the issues in that litigation, only the Utah court should decide those issues, once this Court grants relief from the automatic stay to permit that case to proceed. IBM sets forth this description here only as background to its Objection and to explain IBM's interest in SCO's proposed sale of assets.

[3] At the section 341 hearing, SCO CEO, Darl McBride, estimated that SCO has "incurred over $50 million" in operating expenses prosecuting these lawsuits. Mr. McBride stated that absent these litigation expenses, SCO's Unix Business would have been both "profitable and cash flow positive" during this time period.

the Unix operating system; whether SCO has the right to control hundreds of millions of lines of computer source code created and owned by IBM; whether SCO has the right to foreclose the use by others of the publicly-available Linux operating system, which includes hundreds of thousands of lines of IBM copyrighted code; and whether IBM has a perpetual and irrevocable license relating to AIX, one of IBM's Unix products.

In a series of decisions, the Utah court called into question the veracity of SCO's statements about its claims and rights and, at least in the IBM case, materially limited SCO's case. More importantly, the Utah court entered an order in the Novell case, rejecting a keystone of SCO's litigation campaign. The court ruled that Novell, not SCO, owns the core Unix copyrights and that Novell has the right, which it has exercised on IBM's behalf, to waive SCO's purported claims against IBM.

While the Utah court has not yet ruled on IBM's summary judgment motions (which concern all of SCO's claims), that court has stated that the Novell ruling "significantly impacts" the IBM case. The parties disagree as to the full effect of the Novell decision on the IBM case, but SCO concedes that the ruling forecloses six of SCO's nine claims against IBM.[4] SCO filed its petition for relief under the Bankruptcy Code on the eve of the trial in the Novell matter—shortly before the Utah court was expected to rule on the pending motions.

While SCO's description of the assets proposed for sale is impenetrably vague, it appears that SCO seeks to sell assets that are at issue in the Utah litigations and to which SCO has either no rights or fewer rights than it claims. For example, IBM has devoted hundreds of millions of dollars to developing Unix source code relating to its AIX and Dynix products. IBM has also

[4] IBM believes the Novell ruling effectively rejects SCO's claims against IBM and effectively grants several of IBM's counterclaims against SCO.

contributed substantial resources to the Linux operating system, to which IBM has made extensive source code contributions (as illustrated in the table attached to this Objection as Addendum A). IBM has contractual and intellectual property rights, which SCO has breached and/or infringed, in both IBM's Unix products and Linux contributions.[5] SCO does not have the rights it purports to have in these assets.

B. SCO's Proposed Sale Free and Clear of its Unix Business.

On October 19, 2007, five weeks after it filed for bankruptcy, SCO signed a Term Sheet with JDG Management Corporation d/b/a York Capital Management to "sell, assign, transfer and convey to Purchaser all right, title, and interest in and to the assets, properties and rights of Seller used or useful in connection with the operation of the SCO Unix Business as conducted in the past, present or proposed to be conducted," apparently free and clear of all liens, claims, interests and encumbrances. (Term Sheet at 1; Mot. ¶ 5.) Included in the asset sale, among other things, is a substantial portion of SCO intellectual property relating to its Unix Business, certain executory contracts that purchaser will select at a later date, and certain litigation rights related to its Unix Business, including lawsuits pertaining to the Linux operating system. (Mot. ¶ 5.)

However, SCO does not list or identify, in the Term Sheet or in the Motion, just what intellectual property SCO purports to sell as part of its Unix Business, including whether SCO intends to sell its Unix-based products that include IBM's copyrighted works. Similarly, SCO does not identify in the Term Sheet or in the Motion which executory contracts it intends to assign in the sale, including whether it intends to assign certain Unix license agreements in

[5] Indeed, SCO has admitted without qualification that it copied, verbatim, the entirety of IBM's copyrighted works in its SCO Linux Server 4.0 and OpenLinux 3.1.1 Asia products.

which IBM has an interest. Nor does SCO identify which litigation rights related to its Unix Business it intends to sell.

SCO describes the total purchase price for the sale as the estimated aggregate amount of "up to $36 million" (the "Purchase Price"). (Term Sheet at 3; Mot. ¶ 10.) The Purchase Price is comprised of: (1) a cash payment of $10 million (subject to reduction for assumed liabilities and the level of accounts receivable at Closing); (2) up to $10 million in the form of a secured litigation credit facility to fund SCO's ongoing litigation against Novell and IBM, which is secured by all of the remaining assets of SCO and must be repaid by SCO with interest and in full by October 31, 2009; (3) up to $10 million in the form of a 20% interest for SCO in future litigation judgments that are contingent and may never be collected by the proposed purchaser; and (4) up to $6 million in the form of revenue share based on sales by the proposed purchaser related to a cross license agreement with SCO, which also includes warrants for the proposed purchaser to purchase up to a 10% interest in cross licensee Me, Inc., a non-debtor affiliate of SCO. (Term Sheet at 3-7; Mot. ¶ 10.) SCO does not provide, in the Term Sheet or in the Motion, any type of financial appraisal or valuation regarding the transferred assets included in the Sale or any estimate of the expected values of the contingent future interests.

The Term Sheet provides that if the proposed purchaser is designated as "stalking horse" under the Bid Procedures Order but is not the successful bidder at auction, or if any of the transferred assets in the sale are purchased by any party other than the proposed purchaser, then the proposed purchaser is entitled to receive from SCO a cash break-up fee in the amount of $780,000 and expense reimbursements in an amount up to $300,000 (which is not conditioned upon any expense documentation). (Mot. ¶ 12.) Further, the proposed Bid Procedures Order sets a minimum overbid requirement of $1,630,000, all in cash. (Mot. ¶ 15(f).)

* * *

Based on these facts, it appears that SCO seeks improperly to sell assets that it does not own, including IBM licenses and IBM copyrighted works; that the proposed sale notice and bid procedures do not comport with even the minimum standards for procedures and notice for a sale under section 363 of substantially all of the assets of the estate; that there is no evidence of any exercise of SCO's business judgment in either the bid procedures and protections or the proposed sale; and that the proposed sale does not provide adequate protection of IBM's interests in the assets to be sold. Therefore, this Court should not approve either the bid procedures or the notice of sale, nor should it approve the sale itself.

Argument

I. SCO'S MOTION, BIDDING PROCEDURES, AND PROPOSED SALE NOTICE ARE DEFICIENT AND SHOULD NOT BE APPROVED.

A. SCO's Motion Does Not Provide Any Information in Support of the Bidding Procedures or Bidder Protections.

To obtain a bidding procedures order and approval of bidder protections such as a break-up fee and expense reimbursement, the requesting party must show that such protections are "necessary to preserve the value of the estate". In re O'Brien Envir. Energy, Inc., 181 F.3d 527, 535-37 (3d Cir. 1999); In re Integrated Res., Inc., 147 B.R. 650, 657 (S.D.N.Y. 1992); In re SpecialtyChem Prods. Corp., 372 B.R. 434, 439-40 (E.D. Wis. 2007). Approval of bidder protections is not warranted where the purchaser has not entered into a legally binding agreement, there is no information on the value of the proposed sale, and there is no evidence as to the time, effort, expense and risk that the purchaser contributed to the proposed sale. See In re Tiara Motorcoach Corp., 212 B.R. 133, 137-38 (Bankr. N.D. Ind. 1997); In re Ancor Exploration Co., 30 B.R. 802, 808-09 (N.D. Okla. 1983) (to approve sale, record must support specific

findings on whether, among other things, other prospective purchasers have been solicited and, if not, the justification for not doing so).

Where a debtor in possession seeks approval of bidding procedures that include a break-up fee and expense reimbursement, courts should "highly scrutinize" any such fees. In re Hupp Indus., Inc., 140 B.R. 191, 195 (Bankr. N.D. Ohio 1992); see also In re Integrated Res., Inc., 135 B.R. 746, 750-51 (Bankr. S.D.N.Y. 1992). Therefore, approval of bidder protections as part of a proposed section 363 sale should be denied if the debtor in possession provides "insufficient information upon which to evaluate the merits of the proposed sale". In re Hupp, 140 B.R. at 195; In re Twenver, Inc., 149 B.R. 954, 956 (Bankr. D. Colo. 1992).

Significant factors to be considered by bankruptcy courts in approving bidding procedures and bidder protections include whether the underlying negotiated agreement is an arms'-length transaction between the estate and the negotiating acquirer and whether any bidder protections would provide a chilling effect on other potential bidders. See, e.g., In re O'Brien, 181 F.3d at 534; In re Integrated Res., 147 B.R. at 657; In re Hupp, 140 B.R. at 194.

1. SCO Does Not Provide Information on the Sale Process.

Here, SCO has not provided adequate information on which creditors and the Court can evaluate the merits of the sale, the bidding procedures, or the bidding protections. The Motion and the Term Sheet do not provide any information concerning a valuation of the assets being sold or describe the process SCO undertook to sell them. SCO does not provide any information on whether it explored any alternatives to selling substantially all of its assets (such as an internal reorganization, as it told this Court it would do at the First Day Hearing) or whether it could conduct a sale in a less hasty manner. Nor does it offer any reason for its haste. SCO does not describe what other bidders it contacted (if any) or whether there was any other interest in the assets that would make bidder protections such as a break-up fee unnecessary. SCO does not set

forth what process it will follow to market the assets for the auction, whether its financial advisor will participate in the process and, if so, how and to what extent. SCO simply asserts an unsupported conclusion that the sale was entered into to "maximize the value of the Debtors' assets" and will result in the highest and best offer and is in the best interests of the estate. (Mot. ¶ 5.) Without some meaningful indication that a bidding procedure will produce bidders and the highest and best offer, there is no basis on which to approve it and authorize an auction.

2. SCO Does Not Provide Information on the Sale Terms.

In addition to lacking information about the sale process, the Motion and the Term Sheet lack adequate information about the assets to be sold, the liabilities to be assumed, the contracts to be assumed and assigned and the associated cure costs, and the litigation to be assigned. The Motion and the Term Sheet also lack adequate information about the purchase price.

First, the description of the assets SCO proposes to sell is inadequate. In the Term Sheet and Motion, SCO says the transferred assets include "the intellectual property of the Debtors' relating to the Unix Business", but fails to identify with any particularity what intellectual property is in fact actually related to the Unix Business. (Mot. ¶ 6(j) (emphasis added).) The Term Sheet and Motion do not specifically identify or list the source code, object code, computer programs, patents and other assets that are included as part of its sale of the Unix Business. Without a detailed list of the intellectual property included in the sale, creditors and this Court cannot evaluate how the sale relates to the business as a whole and SCO's reorganization. They cannot evaluate whether the sale is a sound exercise of business judgment and complies with the other requirements of section 363. Therefore, they cannot evaluate whether pursuing a bid process is a wasteful diversion.

Second, SCO fails to specify which of its executory contracts are being assigned, what the cure costs may be (which will reduce the cash purchase price), or what liabilities are being

assumed (which will also reduce the cash purchase price). It also fails to specify what litigation rights are being sold and instead states vaguely that it is selling all litigation rights against third parties (other than IBM and Novell) pertaining to the Unix Business and/or Unix software, "including, but not limited to, those lawsuits pertaining to the Linux operating system (the 'Linux Litigation')". (Mot. ¶ 6(h) (emphasis added).)

Finally, although the Motion describes a purchase price of "up to $36 million", it provides no information on which to determine whether it is in fact $6 million or $36 million. The estate is promised only $10 million under the terms of the sale, reduced by assumed liabilities, cure costs and accounts receivable variations. (Mot. ¶ 10.) Up to $16 million of the remaining purchase price is entirely contingent, and the balance of consideration is in the form of a high interest rate secured litigation credit facility. SCO makes no disclosure of how it valued that contingent consideration. Without at least that information, creditors and this Court have no way of determining the value of the proposed sale or any of the other matters, discussed below, that depend on a proper valuation.

3. SCO Does Not Provide Information on the Proposed Purchaser's Qualifications.

Further, SCO has not provided information on the proposed purchaser's qualifications of the kind it requires from competing bidders. For example, as part of the bidder protections, SCO requires that to qualify as a competing bidder, each prospective bidder must, among other things:

> c. Provide reasonably satisfactory evidence of its financial ability to (i) fully and timely perform if it is declared to be the Successful Bidder (including but not limited to adequate financial resources or financing commitments to pay the Purchase Price and fund the Litigation Credit Facility in full), and (ii) provide adequate assurance of future performance of all contracts and leases to be assigned to it.
>
> d. Disclose any connections or agreements with the Debtors, the Proposed Purchaser, any other potential, prospective bidder or

> Qualified Bidder, and/or any officer, director or equity security holder of the Debtors or Proposed Purchaser.

(Mot. ¶ 15.) However, the Motion does not provide any evidence, let alone "reasonably satisfactory evidence," that the proposed purchaser satisfies any of the requirements that SCO proposes to impose on competing bidders. The qualification and disclosure requirements in the Bid Procedures should be uniform for both the proposed purchaser and competing bidders.

Without providing basic information concerning the terms, merits, and process of the sale and the qualifications of the proposed purchaser, SCO leaves the Court and its creditors unable to determine if SCO exercised sound business judgment by agreeing to the proposed bidding procedures and fees. It leaves the Court and creditors unable to determine whether the procedures and fees are reasonable, whether they will produce a robust auction (or any auction at all), and whether this Court should approve them.

B. SCO's Proposed Bidder Protections and Fees Are Unreasonable.

The amount of a break-up fee and expense reimbursement must constitute a fair and reasonable percentage of the proposed purchase price and must not be so substantial as to produce a chilling effect on other potential bidders. See, e.g., In re O'Brien, 181 F.3d at 534; In re Integrated Res., 147 B.R. at 657; In re Hupp, 140 B.R. at 194. In determining what is reasonable, courts will generally approve fees and expenses "limited to one to four percent of the purchase price", but are reluctant to approve anything higher absent extraordinary circumstances. In re Tama Beef Packing, Inc., 321 B.R. 496, 498 (B.A.P. 8th Cir. 2005).

To the extent that the Motion reveals the basis for the bidder protections and break-up fee and expenses, they far exceed acceptable bidder protections. Although SCO characterizes the purchase price as "up to $36 million," the estate actually is guaranteed only a maximum of $10 million, subject to reduction for an unstated amount of assumed liabilities. (Mot. ¶ 10.) The $10

million litigation loan to SCO that it must repay at a very steep interest rate cannot be counted as part of the purchase price. The remaining purchase price of up to $16 million is contingent on the proposed purchaser's future and uncertain litigation recoveries and on its future and uncertain sales of mobility products. The contingent consideration is wholly unvalued.

Based on a $10 million maximum guaranteed sale price, SCO's proposed break-up fee of $780,000 is almost 8%. The expense reimbursement fee of up to $300,000 (which SCO does not condition on any documentation) amounts to an additional 3% of the total maximum guaranteed sale price. Together, they total almost 11% of the highest guaranteed sale price, well above what is generally considered reasonable, and will likely have a chilling effect on competing bids. In addition, this high break-up fee and expense reimbursement appear to be payable even if this Court rejects the proposed sale and the assets are later sold to another purchaser in a different auction or under a plan of reorganization. (Mot. ¶ 12.)

The proposed overbid protections are also unreasonable. They require a competing bid to exceed the proposed purchaser's initial bid "by at least $1,630,000 in cash"— over 16% of a $10 million bid. (Mot. ¶ 15(f).) Moreover, the overbid must be all cash, even though the proposed purchaser's bid includes substantial, non-cash contingent components. (Mot. ¶ 15(f).) When an original bid is not all cash, overbids should not need to be all cash. Any competing overbid should therefore also be allowed to include non-cash components, such as better terms for the revenue share agreement, more favorable terms on the litigation proceeds sharing, or any other consideration that would exceed the uncertain future recoveries under the contingent price components.

C. SCO's Proposed Sale Notice Does Not Adequately Describe the Assets To Be Sold or the Sale Terms.

Federal Rule of Bankruptcy Procedure 2002(c) requires the trustee or debtor in possession to give notice of a proposed sale. Although the Rule provides that the notice is sufficient if it generally describes the property to be sold, the description must describe it so that one can reasonably determine what is to be sold. 10 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy, ¶ 6004.03[2] (15th rev. ed. 2007); see also In re Lowe, 169 B.R. 436, 440 (Bankr. E.D. Okla. 1994) (notice is not inadequate if a simple inquiry would reveal defect). The Rule also requires an accurate description of the terms and conditions of the sale, including price. See In re Ryker, 301 B.R. 156, 167-69 (D.N.J. 2003). Failure to satisfy either of these requirements will justify invalidating any sale conducted under the defective notice. See Wintz v. Am. Freightways, Inc. (In re Wintz Cos.), 219 F.3d 807, 813 (8th Cir. 2000); In re Ryker, 301 B.R. at 167-69; In re American Freight Sys. Inc., 126 B.R. 800, 803-05 (D. Kan. 1991).

The Motion's lack of information about sale terms is reflected in the proposed Sale Notice as well. As described above, the description of the assets to be sold is so ambiguous and uncertain that the inadequacy cannot be cured by a simple inquiry. The inadequate notice will defeat a fair auction and prevent creditors and other parties in interest from protecting their interests during the sale process.

Because the description of the assets SCO proposes to sell is inadequate, potential bidders will be left in the dark about what intellectual property they are bidding for and will be reluctant to make a competing bid. Similarly, without a list of the intellectual property included in the asset sale, those parties who claim an ownership interest in some of the intellectual property that SCO claims to own or control (such as IBM's copyrighted works or Novell's Unix copyrights) will not have adequate notice of whether SCO plans to include such property as part of the

transferred assets. This will prevent IBM from being able to protect its property rights adequately and will leave any potential purchaser of the transferred assets uncertain about their ownership.

A purchaser's opportunity to include or exclude certain executory contracts or license agreements as part of the asset sale will create uncertainty for licensees such as IBM, who do not know whether their license agreements with SCO are going to be transferred. As noted above, IBM has license agreements concerning Unix System V in which SCO claims an interest. Without knowing exactly what licenses are included in the transferred assets, licensees such as IBM will be unable to determine what action, if any, they need to take to protect their rights as licensees under sections 363 and 365(n).

By using ambiguous language in describing the types of litigation rights being sold, coupled with the ambiguity concerning what underlying intellectual property is being sold, potential bidders and current defendants in SCO lawsuits (such as IBM, Novell, Red Hat, Inc. and Autozone, Inc.) can only speculate about who ultimately has the right to continue current lawsuits or pursue potentially new causes of action. Given the uncertainty concerning ownership over much of its intellectual property, it is imperative that SCO specify the exact litigation rights it intends to sell and those it intends to retain.

Finally, as discussed above, without any disclosure of how SCO valued the contingent consideration, a competing bidder, creditors, and this Court would have no way of determining whether another bid, which may or may not include contingent recoveries, is more or less than the proposed purchaser's bid. "Up to" $16 million is simply not enough information on which to conduct an auction. Neither is the limited description of assets, contracts, and litigation.

II. SCO'S PROPOSED ASSET SALE IS IMPROPER AND UNSUPPORTED BY ANY EVIDENCE.

Given the skeletal information provided by SCO in support of its proposed sale, IBM is able to set forth only preliminary objections to the proposed transaction. In doing so, IBM does not waive its right to make additional objections to the sale or to demand the protections to which IBM is entitled under the Bankruptcy Code, should this Court approve the Bid Procedures Order and SCO then provides a complete description of the assets to be sold and the terms and conditions of the sale. If it is apparent that the sale in its present form cannot be approved, then this Court should not approve bidding procedures, bidder protections, and an auction.

A. SCO's Proposed Sale Free and Clear of Disputed Assets is Improper.

Before a trustee or debtor in possession may sell any property as property of the estate, the bankruptcy court must first determine whether, in fact, the estate owns the property. The court may not sell property free and clear of a disputed ownership interest. See Darby v. Zimmerman (In re Popp), 323 B.R. 260 (B.A.P. 9th Cir. 2005); In re Claywell, 341 B.R. 396, 398 (Bankr. D. Conn. 2006); In re Rodeo Canon Dev. Corp., 362 F.3d 603, 608 (9th Cir. 2004), op. w'drawn and remanded by Warnick v. Yassian (In re Rodeo Canon Dev. Corp.), No. 02-56999, 2005 U.S. App. LEXIS 3786 (9th Cir. Mar. 8, 2005) (case settled while motion for rehearing pending). To make this ownership determination, the bankruptcy court must first resolve any adverse claims of ownership made by parties other than the estate. See In re Rodeo Canon, 362 F.3d at 608. Failure to make this determination before a purported "free and clear" sale divests the court of any authority to approve such a sale. Id. at 610.

Here, SCO seeks Court approval to sell "substantially all of [its] assets relating to its Unix operating system ... free and clear of all liens, claims, interests and encumbrances". (Mot. ¶ 5.) However, such approval would be improper to the extent SCO intends to include

certain Unix copyrights and IBM's copyrighted works in the sale, because Novell and IBM, respectively, and not SCO, own (or at the very least have ownership claims to) these assets. (Obj. at 5-6.) As noted, the Utah court has ruled that Novell is the rightful owner of the Unix copyrights, and SCO itself has admitted to copying the IBM copyrighted works into its Linux products. (Obj. at 5-6 & n.5.) Therefore, this Court lacks the authority to approve SCO's asset sale free and clear of adverse ownership claims to the extent the sale includes Novell's and IBM's property. See In re Rodeo Canon, 362 F.3d at 610.[6]

In addition, SCO's sale terms describing which claims and liabilities are included and which are excluded are vague and ambiguous. To the extent SCO intends to sell assets free and clear of any claims that IBM may have against a purchaser for unlicensed future use of IBM's copyrighted works, IBM similarly objects. Bankruptcy laws do not eliminate successor liability for post-sale conduct. See Schwinn Cycling and Fitness, Inc. v. Benonis, 217 B.R. 790, 796-97 (N.D. Ill. 1997); see also White v. Chance Indus., Inc. (In re Chance Indus., Inc.), 367 B.R. 689, 706 (Bankr. D. Kan. 2006) ("to the extent [plaintiff's] claims against CRM or the reorganized debtor are based upon post-confirmation conduct rather than pre-petition conduct, they would not be ... discharged".). Therefore SCO cannot, through the expedient of a bankruptcy sale, eliminate any claims IBM may assert against a subsequent purchaser of SCO's Unix Business for claims accruing after the sale.

[6] Similarly, to the extent SCO purports to sell Unix System V licenses to which IBM is a party "free and clear of all liens, claims, interests and encumbrances", IBM objects and reserves its licensee rights under sections 363 and 365(n). See Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537, 548 (7th Cir. 2003) (lessees have the right to seek protection under section 363, and "upon request, the bankruptcy court is obligated to ensure that their interests are adequately protected.").

B. The Asset Sale Improperly Includes a Secured Loan with Post-Confirmation Repayment Terms.

A trustee may obtain secured credit only if approved by the court after notice and a hearing under section 364, not as part of an asset sale under section 363. See 11 U.S.C § 364. Here, the debtor improperly seeks to include a secured loan as part of the consideration for the transferred assets. As noted, $10 million of the purported $36 million purchase price is "in the form of a litigation credit facility to fund litigation expenses". (Mot. ¶ 10.) According to the Term Sheet, this credit facility will be secured by a first priority lien in all present and future SCO assets, will have superpriority status, will accrue interest, and will remain available to SCO after it emerges from bankruptcy. (Term Sheet at 6.) The litigation credit facility therefore clearly represents a secured loan and should be considered separately from any consideration relating to a section 363 sale. Yet, the Motion offers no justification for the loan nor any evidence that would satisfy section 364's requirements.

SCO also fails to explain what, if any, repayment sources there are. Since SCO proposes to pledge all its remaining assets as collateral for the loan, any SCO reorganization plan, even if confirmable, could be scuttled by its inability to repay the loan.

C. SCO Has Failed To Provide Sufficient Evidence that the Asset Sale Is a Sound Exercise of Business Judgment.

To obtain approval for a sale under section 363(b), the trustee or debtor in possession must present evidence demonstrating "a good business reason to grant such an application." In re Lionel Corp., 722 F.2d 1063, 1070 (2d Cir. 1983); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (Bankr. D. Del. 1999). In evaluating whether a sound business reason justifies the use, sale or lease of property under section 363, courts will often consider the following factors, among others: (1) the proportionate value of the asset to the estate as a whole;

(2) the amount of elapsed time since the filing; (3) the effect of the proposed disposition on a future plan of reorganization; and (4) the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property. See, e.g., In re Lionel Corp., 722 F.2d at 1071; In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176 (Bankr. D. Del. 1991). Here, SCO has not presented any evidence on these factors that would allow either the Court or SCO's creditors to determine whether SCO has exercised sound business judgment in selling substantially all of its assets, let alone for a maximum guaranteed payment of only $10 million.

First, SCO does not value the assets being sold compared to the assets of the estate as a whole. The Motion does not provide any financial information regarding the assets SCO plans to divest and those it plans to retain. Without basic financial statements concerning sales, revenue, income, etc., generated by either the transferred assets or those assets (if any) that will remain, the Court and SCO's creditors are left only to guess about the proportionate value of the sale compared to that of the estate as a whole.

Second, SCO filed for bankruptcy protection less than two months ago and, outside of a few general references to declining revenues and skittishness of existing and prospective customers about its bankruptcy, it has not provided any explanation or justification for the undue haste in which it has entered into this sale of substantially all of its assets. (Mot. ¶ 5.) Indeed, during its First Day Hearing, SCO told the Court that it filed for bankruptcy protection in large part to give it breathing space and time to reorganize its businesses and reformulate its business plan. (D.I. 59 at 8-10.) Now, before its Chapter 11 case has progressed in any substantial manner, SCO apparently seeks to sell the majority, if not all, of its business for what amounts to, at most, $10 million in guaranteed payments, some contingent future payments, and a loan to continue its longstanding, expensive and unsuccessful litigation against Novell and IBM.

Without providing some details concerning the necessity for entering into the sale so quickly (coupled with the lack of financial disclosure relating to the sale), this Court and SCO's creditors are left unable to determine any reason for the rush to sell or how this may fit into an overall restructuring strategy.

Third, SCO does not address how selling a substantial portion of its assets and entering into a loan with post confirmation repayment terms will affect any future Chapter 11 plan. Without some explanation from SCO concerning this important issue, the Court and SCO's creditors cannot help but be concerned that the proposed sale is an attempt by SCO to continue an unsuccessful and expensive litigation strategy without any serious intent to bring business solutions to bear on its underlying business and financial problems.

Finally, SCO has not provided any valuation of the assets being sold. Without any type of valuation by SCO's outside financial advisor or even by SCO itself, neither the Court nor SCO's creditors can begin to determine if the Purchase Price is fair or reasonable. At its First Day Hearing, SCO touted the significant value of its intellectual property, but now purports to sell most or all of it for, at most, only $10 million in guaranteed payments. Absent some credible evidence of what the assets are actually worth, the Court and SCO's creditors will not be able to determine if that is an appropriate price.

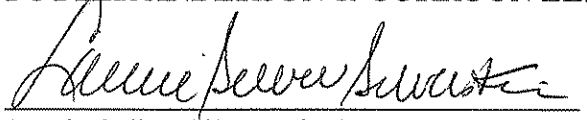
Conclusion

SCO has asked the Court to approve an "emergency" request to permit the sale of what appears to be much, if not all, of SCO's business assets. The procedure that led to the proposed transaction, the procedure for going forward with it (or an alternative), and the requisite showing of the support for its terms and conditions are all absent. So, too, is any proffered justification for the sale itself or any explanation for SCO's apparent abandonment of its stated intentions

when this reorganization proceeding began less than two months ago. Accordingly, IBM requests that the Court deny SCO's Motion.

Dated: November 1, 2007

POTTER ANDERSON & CORROON LLP

By: 

Laurie Selber Silverstein (No. 2396)
Gabriel R. MacConaill (No. 4734)
Hercules Plaza
1313 North Market Street, 6th Floor
Wilmington, Delaware 19801
Telephone: (302) 984-6000
Facsimile: (302) 658-1192

-and-

CRAVATH, SWAINE & MOORE LLP
Richard Levin
David R. Marriott
Worldwide Plaza
825 Eighth Avenue
New York, New York 10019
Phone: (212) 474-1000
Facsimile: (212) 474-3700

Of Counsel:

INTERNATIONAL BUSINESS MACHINES CORPORATION
Alec S. Berman
1133 Westchester Avenue
White Plains, New York 10604
(914) 642-3000

Attorneys for International Business Machines Corporation

Pac#829277