IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
The SCO GROUP, INC., et al.,[1]	)	Case No. 07-11337 (KG)
	)	(Jointly Administered)
	)	
Debtors.	)	

Hearing Date: March 7, 2008 at 2:00 p.m. prevailing Eastern time
Objection Deadline: February 29, 2008 at 4:00 p.m. prevailing Eastern time

DEBTORS' MOTION FOR A DETERMINATION THAT INCENTIVE BONUSES FOR QUARTER ENDING OCTOBER 31, 2007 WERE PAID IN THE ORDINARY COURSE OF DEBTORS' BUSINESS FOR CONTINUING AUTHORITY TO PAY ORDINARY COURSE OF BUSINESS INCENTIVE BONUSES

The SCO Group, Inc. and SCO Operations, Inc. (collectively, the "Debtors") seek a determination that incentive bonuses paid by the Debtors pursuant their 2007 Employee Incentive Bonus Program for the quarter ending October 31, 2007 were made in the ordinary course of the Debtors' business and authority to continue to pay similar incentive bonuses for each quarter thereafter. In support of this motion (the "Motion"), the Debtors respectfully state as follows:

Preliminary Statement

1. Each year since 2003, the Debtors have maintained a quarterly incentive bonus program for their employees. On the Petition Date (ad defined below), the Debtors filed the *Debtors' Motion for an Order (i) Authorizing the Debtors to (a) Pay Prepetition Wages,*

[1] The Debtors and the last four digits of each of the Debtors' federal tax identification numbers are as follows: (a) The SCO Group, Inc., a Delaware corporation, Fed. Tax Id. #2823; and (b) SCO Operations, Inc., a Delaware corporation, Fed. Tax ID. #7393.

Salaries, Commissions, Employee Benefits and Other Compensation; (b) Remit Withholding Obligations; (c) Maintain Employee Benefits Programs and Pay Related Administrative Obligations; and (ii) Authorizing Applicable Banks and Other Financial Institutions to Receive, Process, Honor and Pay Certain Checks Presented for Payment and to Honor Certain Fund Transfer Requests (Docket No. 8) (the "Wage Motion"), which was approved by the Court (Docket No. 27) (the "Wage Order"). The Wage Order approved continuation of the Debtors' pre-existing incentive bonus program as an "ordinary course of business" program that could be honored by the Debtor on a post-petition basis. The Office of the United States Trustee commented on the form of the Wage Order but did not object to the entry of the Wage Order.

2. Thereafter, the Office of the United States Trustee ("UST") informally requested information regarding the payment of an incentive bonuses made by the Debtors. The Debtors provided the requested information. Subsequently, the UST informed the Debtors that the UST was concerned that the payments made under the incentive bonus program for the quarter ending October 31, 2007, were not made in the ordinary course of the Debtors' business. The Debtors disagreed with the UST on this point and offered to provide the UST any additional information needed to give the UST assurance that the incentive bonus was made consistent to the Wage Order and made in the ordinary course of the Debtors' business. The UST requested that the Debtors file this Motion seeking a determination that the bonus payments were made in the ordinary course of the Debtors' business and informed the Debtors that, if they failed to do so, the UST would seek such determination.

3. As such, the Debtors file this Motion to again seek a determination that the incentive bonus program for the Debtors' employees is in the ordinary course of the Debtors' business.

Jurisdiction

4. This Court has jurisdiction over these cases under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2) (A) and (M).

5. The statutory bases for the relief requested herein are sections 105, 363(c) and 1108 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

Relevant Background[2]

A. Ordinary Course Incentive Bonus for Quarter Ending October 31, 2007

6. Prior to September 14, 2007 (the "Petition Date"), the Debtors established an Employee Incentive Bonus Program for the Debtors' fiscal year 2007 (the "2007 Incentive Program"), designed to reward employees for their contributions to the successful achievement of certain corporate goals and objectives and to share the success, and risks, of the Debtors' business based upon successful achievement of quarterly business goals. A copy of the 2007 Incentive Program is attached hereto as Exhibit A. Concurrently herewith, and out of an abundance of caution, the Debtors are filing a motion seeking to present evidence and testimony to be offered at the hearing on this Motion, under seal.

[2] For a detailed description of the Debtors' background and 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* (Docket No. 3).

7. Pursuant to the 2007 Incentive Program, eligible employees were entitled to be paid bonuses to the extent that certain revenue and net operating income/loss as well as personal performance objectives were achieved (the "Performance Metrics"). An employee is eligible to receive a certain percentage of his or her salary as an incentive bonus ranging from 4% up to 70% (4% employee, 8% manager, 12% director, 20% VP, 40% SVP and 70% CEO) with the revenue objective accounting for 40% ("Revenue Objective"), the net income/loss objective accounting for 40% ("Net Operating Objective"), and the personal objective for 20% of the eligible incentive bonus ("Personal Objective") if the employee achieved or exceeded the performance metrics established under the Plan (collectively, the "Incentive Bonus"). Each component of the Incentive Bonus is insular and can be paid independently even if the other components are not met (for example, if an eligible employee meets his Personal Objective, but the Revenue Objective and the Net Operating Objective are not met, the eligible employee will receive 20% of the Incentive Bonus).

8. At the end of the quarter ending October 31, 2007, the compensation committee of the Board of Directors (the "Board") reviewed the Incentive Bonus, including the three objectives individually, before awarding the Incentive Bonus. For the quarter ending October 31, 2007, the Board, in their business judgment, made the following findings:

a. *Revenue Objective*: The revenue objective for the Debtors was exceeded, therefore, the Board approved this portion of the Incentive Bonus.

b. *Net Operating Objective:* The target for the Net Operating Objective was not met; however the Board determined that despite the actual results not meeting the targeted operating loss that the eligible employees earned 100% of this portion of the bonus. The Board made this determination, in its business judgment, because the management team did not have control of various factors, including the costs of the bankruptcy administration and, at the time, the Debtors were contemplating a sale of the Unix business, and the potential purchaser insisted on various strategies, such as to delay a reduction-in-force which the management wanted to implement. Therefore, after an adjustment to the net operating loss, based on the Board's business judgment, the Net Operating Objective was met and approved.

c. *Personal Objective:* Each quarter every eligible employee creates personal objectives for themselves. The personal objectives are then approved by the employee's supervisor (or in the case of an executive, by the Board). For the quarter ending October 31, 2007, each eligible employee's personal objectives included, but were not limited to, the following: (i) support the bankruptcy filing and the additional work required to support the Court's requirements; (ii) provide due diligence support for the marketing and sale of the Unix business with potential buyers; and (iii) provide additional leadership and assumed responsibilities due to reduction in personnel. At the end of the quarter, the executive management team and departmental managers ranked their employees regarding each eligible employee's Personal Objective. The Board relied upon management's evaluations and, in addition, determined whether each executive reached their individual Personal Objective.

9. During the quarter ending October 31, 2007, the Board determined that the each eligible employee achieved all three of the required Performance Metrics established pursuant to the Incentive Plan.

10. Sixty employees (three of whom are officers) received bonuses aggregating $150,157.21 for the quarter ending October 31, 2007 (collectively, the "Q4 Bonuses").

11. The potential Incentive Bonus is typically paid 45 days after the end each quarter.

B. <u>Historical Ordinary Course Incentive Bonuses</u>

12. The Debtors implemented incentive programs similar to the 2007 Incentive Program for fiscal years 2006 and 2005.

13. In 2004, employees (other than the Chief Executive Officer) were eligible to earn quarterly and annual performance awards based on: (i) operating results for the Company's UNIX division, (ii) management of the Company's intellectual property litigation and (iii) objectives related to simplifying the Company's capital structure. During the 2004 fiscal year, the Debtors' executives (other than the Chief Executive Officer) received quarterly and annual performance awards of aggregating approximately $234,000, based on the attainment of the corporate objectives specified for each executive.

14. In 2003, eligible employees (other than the Chief Executive Officer) could earn a quarterly performance award on the basis of: (i) achievement of positive operating margin for the Company's UNIX business and (ii) achievement of certain financial goals and agreed upon objectives as approved by the Board of Directors and executive management. During fiscal year 2003, quarterly performance awards were earned during the fourth quarter, based on the

attainment of contribution margin by the Debtors' UNIX business and achievement of the agreed upon financial goals.

15. Each executive officer (other than the Chief Executive Officer whose quarterly performance awards are described below in CEO compensation) may also earn a quarterly performance award on the basis of: (i) performance of agreed upon objectives between the executive officer and the Chief Executive Officer prior to the start of each quarter; and (ii) achievement by the Company of certain financial goals as approved by the Board of Directors and executive management. During fiscal year 2002 no quarterly performance awards were paid.

16. It has always been the Debtors' policy that prior to the payment of any quarterly bonus, the achievement of the financials goals must be attained in any given quarter. As set forth above, the Debtors achieved the financial goals set by the Debtors' Board of Directors for the quarter ending October 31, 2007.

17. Per an informal agreement between the Office of the United States Trustee and the Debtors, upon payment of any ordinary course incentive bonus, the Debtors would provide information regarding the payment to the United States Trustee's office. Although the Debtors believe the 2007 Incentive Bonus for the quarter ending October 31, 2007, was paid in the ordinary course of business, the Office of the United States Trustee had concerns and requested that the Debtors file this Motion.

Relief Requested

18. The Debtors have been urged by the United States Trustee to seek a determination that the Q4 Bonuses were made pursuant to the Incentive Program in the ordinary course of business and authority to continue to pay similar incentive bonuses for each quarter thereafter.

Basis for Relief Requested

19. The Bankruptcy Code provides, in relevant part:

> [T]he [debtor in possession] may enter into transactions … in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business, without notice or hearing.

11 U.S.C. § 363(c)(1). Further, "the [debtor in possession] may operate the debtor's business" unless otherwise ordered by the Court. 11 U.S.C. § 1108.

20. On the other hand, transactions outside the ordinary course of business are subject of notice, hearing and court approval. *See* 11 U.S.C. § 363(b).

21. "Although the determination of whether a transaction is in the ordinary course of business can have broad implications, '[n]either the Bankruptcy Code nor its legislative history provides a framework for analyzing whether particular transactions are in the ordinary course of a debtor's business.'" *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 797 (Bankr. D. Del. 2007) (quoting *In re Roth American, Inc.*, 975 F.2d 949, 952 (3d Cir. 1992)).

22. "In order to determine whether or not a transaction falls in the ordinary course of business most courts, including the Third Circuit, have adopted a two-step inquiry." *Id.* "This inquiry consists of looking at the transaction from horizontal and vertical dimensions."

Id. "The test for the horizontal dimension 'is whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry.'" *Id.* (quoting *Roth American* at 953). The vertical dimension "analyzes the transactions from the vantage point of a hypothetical creditor and the inquiry is whether the transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided to extend credit." *Id.* (quoting *Roth American* at 953). Pursuant to the vertical test, "a debtor's pre-petition business practices and conduct is the primary focus of the vertical analysis." *Id.* "The Court must 'also consider the changing circumstances inherent in the hypothetical creditor's expectations.'" *Id.*

23. The Debtors submit that the horizontal and vertical dimensions are met. The quarterly performance awards subject of the Incentive Program are common in the Debtors' industry, evidence of which will be proffered at the hearing on this Motion. With respect to the so-called "vertical test", the evidence will clearly show that the Debtors have had the Incentive Program, and others like it since at least 2002, a fact that is well-known through the filings required of public companies, so hypothetical creditors would be well aware of the "risk" inherent in the Incentive Program.

24. Accordingly, the Debtors submit that the Q4 Bonuses were made in the ordinary course of business.

<u>Notice</u>

25. Notice of this Motion has been or will be given to the following parties or, in lieu thereof, to their counsel, if known: (i) the Office of the United States Trustee; (ii) the creditors holding the 20 largest unsecured claims against the Debtors' estates (on a consolidated

basis); and (iii) any party which has filed a request for notices with this Court prior to the date of this Motion. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

WHEREFORE, the Debtors respectfully request that the Court enter an order determining that the Q4 Bonuses were paid in the ordinary course of business, and granting such other and further relief as is just and proper.

Dated: February 13, 2008

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