IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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| In re: | ) | Chapter 11 |
| | ) | |
| The SCO GROUP, INC., et al.,[1] | ) | Case No. 07-11337 (KG) |
| | ) | (Jointly Administered) |
| Debtors. | ) | **Hearing Date: June 15, 2009 at 2:00 P.M.** |

**DEBTORS' RESPONSE TO MOTIONS TO DISMISS OR CONVERT FILED BY UNITED STATES TRUSTEE (D.E. #750), INTERNATIONAL BUSINESS MACHINES CORPORATION (D.E. #751), AND NOVELL, INC. (D.E. #753)[2]**


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[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.

[2] The Debtors' response addresses three separate motions to convert and, to the extent necessary, the Debtors request a waiver of the page limitations imposed by this Court's General Chambers Procedures (4/19/2006)

## TABLE OF CONTENTS

The above-captioned debtors (collectively, the "Debtors")[3] hereby file this combined response to the motions of the United States trustee (D.E. #750), IBM Corporation ("IBM") (D.E. #751), and Novell, Inc. ("Novell") (D.E. #753) for dismissal or conversion of these cases to cases under Chapter 7 (collectively the "Motions") and state for the reasons set forth below that the Motions should be denied.

## INTRODUCTION

After spending more than six years and tens of millions of dollars contesting SCO's claims against them, IBM and Novell now ask the Court to dismiss or convert SCO's bankruptcy cases on the eve of an imminent decision by the United States Court of Appeals for the Tenth Circuit on critical issues at the heart of SCO's claims. IBM and Novell bring their motions even though a reversal on any of the three issues pending before the Tenth Circuit will rehabilitate SCO, and even though a reversal will allow SCO to proceed against IBM, Novell, and others on significant claims of extraordinary value to the estate. Against this backdrop, the Motions can be seen for what they are – ploys by IBM and Novell to avoid responsibility for their actions against the estate on the pretense that they are now acting in its interest.

As of their last quarterly filings, IBM, currently listed as No. 14 among the Fortune 500,[4] is a global company with a market capitalization of $128 billion[5] and Novell is a global company with a market capitalization of approximately $1.42 billion.[6] It strains credulity for such behemoths to argue that Novell's $3.5 million judgment against SCO – and not their desire to neutralize the threat that SCO's rights pose to their interests and to avoid billions of dollars in

[3] "SCO" refers to The SCO Group, Inc.

[4] *Fortune 500 2008*, Money.CNN.com, 5 May 2008.

[5] *International Business Corporation Key Statistics,* Finance.yahoo.com 4 June 2009.

[6] *Novell Inc. Summary,* Finance.yahoo.com 4 June 2009.

potential damages – is the impetus for their Motions. Nor can IBM and Novell even remotely argue that they are leading the way in preserving money for SCO's pre-petition creditors. There is no creditors committee (because no one showed up to form one), and no pre-petition creditor has asked for SCO to be liquidated or shackled in any way. Instead, the Debtors expect that several have asked or will ask the Court to deny the Motions.

SCO's claims against IBM and Novell stem from their concerted efforts to promote the Linux operating system at the expense of SCO's core asset, the UNIX operating system and intellectual property. SCO's claims are supported by evidence that IBM contributed valuable UNIX-derived technology to Linux development in order to transform Linux from a hobbyist's program into a viable competitor. SCO's claims are supported by such IBM admissions as Linux is "Derived from UNIX" and that "UNIX was a pre-write of Linux," and by credible and extensive expert testimony that Linux is indeed a derivative of UNIX under the Copyright Act. By seeking to liquidate SCO before the Tenth Circuit decides critical issues underlying SCO's claims, IBM and Novell seek to avoid responsibility for their actions in support of Linux – precisely the actions that damaged SCO's business to the point of bankruptcy.

IBM has profited from its transformation of Linux to the tune of billions of dollars in quarterly revenues and profits from the sale of hardware, software, and services as part of integrated "Linux solutions," where Linux – an open source program – is included in the solution at little or even no cost to the customer. As described in detail in the Appendix hereto, IBM set out to transform Linux into an enterprise-grade operating system to gain a competitive advantage and currently bases its core business model on its Linux solutions. Similarly, Novell is a self-proclaimed "ardent supporter of Linux" and owns one of the major Linux distributors in the

world, thanks in part to a $50 million investment from IBM made after SCO brought its claims against IBM.

SCO represents a daunting threat to IBM and Novell, even setting aside the billions of dollars that SCO stands to recover directly if it prevails in court. Since SCO claims copyrights and contractual rights in UNIX and has amassed credible evidence that Linux is an unauthorized derivative of UNIX, SCO represents a threat to the very lifeblood of the Linux-based business model IBM and Novell have adopted. If SCO establishes those rights in court, SCO also would have profitable claims in countless Linux distributions to customers who could then potentially seek indemnification from IBM and Novell.

The Tenth Circuit has thus far handled the pending appeal on an expedited basis, setting a date for oral argument only days after SCO's initial brief was filed, and by all indications will issue a decision promptly. Judge Michael McConnell, one of the panel members deciding the appeal, has announced that he will retire from the bench on August 31, 2009, making it highly probable that a decision will issue by that date. In light of the likelihood of SCO's rehabilitation if it prevails on even one of the three issues on which the panel is set to rule and since the company stands to proceed on its significant claims against IBM and Novell with a reversal, there is simply nothing to be gained and everything to lose by converting these cases before the Tenth Circuit issues its decision.

## BACKGROUND

On September 14, 2007 (the "Petition Date"), the Debtors each filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

On May 5, 2009, the United States trustee filed a motion to dismiss these cases or to convert them to cases under Chapter 7. On May 11, 2009, five days after SCO's appeal to the Tenth Circuit was argued, both IBM and Novell filed their own motions.

The Debtors respect the United States trustee's bona fides in filing her motion but dispute those of IBM and Novell, the judgment creditor whose claim is subject to appeal and to the Debtors' substantial offsetting claims.

The Debtors have tried to avoid involving the Court in the merits of the competing claims of these parties, but can no longer do so in light of the terminal nature of the relief the Movants now seek. When considering whether the Movants have established "cause," the Court will need to evaluate whether the cash lost by the Debtors during their stay in Chapter 11 can be considered "substantial" in light of their other assets, including the claims for damages against IBM, Novell, and others. The litigation claims are also relevant to the question of whether there is a reasonable likelihood of rehabilitation. *See, e.g., In re Original IFPC Shareholders, Inc.*, 317 B.R. 738, 742-43 (Bankr. N.D. Ill. 2004) (weighing the strength of a debtor's litigation claims in deciding whether the debtor had a reasonable likelihood of rehabilitation). Moreover, it is imperative that the Court understand the ramifications of a ruling that would put the Debtors out of business. Such consideration is implicit in the discretion afforded to bankruptcy courts to decide: First, whether "unusual circumstances" exist notwithstanding a finding of "cause" to avoid granting dismissal or conversion; and second, even if the Court did not find unusual circumstances, to decide which among the three (or four) forms of relief provided for under section 1112(b)(1) of the Bankruptcy Code the Court should choose. *Id.* at 753-54.

## ARGUMENT

### I. THE MOTIONS SHOULD BE DENIED BECAUSE THERE IS NO CAUSE TO DISMISS OR CONVERT THE CASES.

#### A. "Cause" Does Not Exist Under Section 1112(b)(4)(A).

To dismiss or convert a Chapter11 case for "cause" under § 1112(b)(4)(A), the court must find (a) a substantial loss or diminution of the estate, and (b) the absence of a reasonable

likelihood that the estate will be rehabilitated. The Debtors submit that the record will be insufficient to establish either prong of the rule, let alone both.

1. There Has Been No "Substantial" Diminution of the Estate.

While the Debtors do not claim to have generated a profit during their 19 months in Chapter 11, the losses do not approach the magnitude asserted by the Movants. For starters, the true aggregate net operating loss over that time period was only $4,357,000 – approximately half of what the Movants alleged based on the monthly operating reports ("MORs").[7] These operating results were not unexpected, given the losses incurred historically.

The primary component of the aggregate net operating loss consists of bankruptcy and related reorganization expenses of $2,305,000 – over 50% of the aggregate net operating loss. Litigation expenses related to the multiple-day trial in the Novell case came to $1,491,000 – or about 34% of the aggregate net operating loss. Together, legal issues in and out of bankruptcy account for over 84% of the Debtors' aggregate net operating loss. The other 15% – $561,000 – are true losses from business operations. That figure over 19 months equates to an operating loss of just over $29,500 a month. Isolating the pure UNIX/OpenServer products business, the MORs confirm Mr. McBride's assertion that the Debtors have recently run at or near break-even.

The $3.5 million cash erosion in those 19 months, due primarily to the high cost of litigation and restructuring is of concern. When averaged over that time period, the rate of cash burn is around $184,000 a month. The MORs show that the greatest portion of that cash erosion occurred when the Debtors employed a team of lawyers and investment bankers to try to accomplish an early and profitable exit from Chapter 11 with the York deal. That aborted effort

[7] The MORs include non-cash items. As of the latest MOR, aggregate non-cash items listed as part of losses totaled $4,295,000.

cost the Debtors $695,000 in cash. Taking away those months of cash-burn yields a more-normal rate of reduction of $150,000 per month.

Although the Debtors thus have experienced continuing losses, the losses are not substantial. "Courts must evaluate losses on a case-by-case basis. Small losses over an extended period may be acceptable, whereas large losses in a short period may indicate that rehabilitation is not likely." *In re AdBrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003). Moreover, "a court must make a full evaluation of the present condition of the estate, not merely look at the debtor's financial statements." *Id.* "Negative cash flow and an inability to pay current expenses as they come due can satisfy the continuing loss or diminution of the estate for purposes of § 1112(b)." *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 564 (Bankr. M.D. Pa. 2007) (emphasis added); *see also AdBrite*, 290 B.R. at 215 ("Negative cash flow is considered by courts to be evidence of continuing losses required by section 1112(b)(1)" (quoting *In re Galvin*, 49 B.R. 665, 669 (Bankr. D. N.D. 1985) (emphasis added)). A bankruptcy court "has wide discretion to determine if cause exists and how to ultimately adjudicate the case." *In re 1031 Tax Group, LLC,* 374 B.R. 78, 93 (Bankr. S.D.N.Y. 2007). And, as the court in *Gateway* explained, such findings do not *ipso facto* satisfy the continuing loss standard under § 1112(b)(4)(A).

The word "substantial" implicitly begs the question: Substantial compared to what? Compared to the Debtors' losses before bankruptcy, these losses are hardly substantial.

SCO had only one profitable quarter of operations – the quarter ended April 30, 2003. The profit resulted principally from SCOsource licensing activity with Sun Microsystems and Microsoft Corporation, licensing activity that then was undermined by Novell claiming it owned the UNIX copyrights, which is one of the issues before the Tenth Circuit on appeal. For the fiscal years ended October 31, 2002, through September 2007, SCO generated cumulative net

operating losses of $83.4 million and used cash in operations of $58.0 million, representing a monthly burn rate of $800,000 over the 71-month period.

Cumulative losses generated by SCOsource and SCO's litigation efforts for those periods was $39.6 million, with cash used in operations of $29.6 million. Cumulative losses from operation from SCO's UNIX and mobility businesses for those periods was $43.8 million and cash used in operations was $26.1 million, representing a monthly burn rate of $368,000 over the 71-month period.

As a result of the bankruptcy, management has reduced R&D efforts on its UNIX and mobility businesses, limiting new product enhancements and development; reduced staffing levels to match to the declining revenue streams; and thereby improved the monthly cash burn rate from $368,000 to approximately $29,500.

Compared to a market basket of other software companies, again these losses are hardly substantial. It is not uncommon for software companies to rack up large operating losses and then get purchased for substantial sums of money. For example, JBoss reported revenues for 2006 of $16 million and a net loss of $22 million. Red Hat acquired JBoss in 2006 for $420 million. Similarly, in 2003, SuSE was purchased by Novell (with assistance from IBM) for $210 million after racking up losses in the tens of millions of dollars.

Compared to the improvement in the liabilities side of the Debtors' balance sheet, the losses are not substantial. When these cases commenced, the Debtors' liabilities included claims asserted by Novell of approximately $40 million, by the IPO class action claimants of $59 million, and by SuSE of (apparently, based on its proof of claim) $1.3 million. But since then

the Debtors, by expending about $1.5 million, reduced the Novell claim to $3.5 million,[8] and completely eliminated the liabilities to the IPO claimants and to SuSE (by its in-court waiver). Therefore, in the last 19 months, the Debtors reduced cash by $3.5 million but reduced liabilities by about $97,000,000. In short, the Debtors have used Chapter 11 for the precise purpose it is designed – to improve their operations and rehabilitate their business.

The Debtors below explain how their assets include claims worth billions of dollars. *See* Parts I.A.3-5, below. Compared to the Debtors' assets, the losses occasioned in order to preserve these litigation assets are *de minimis*, not substantial.

2. There Is a Reasonable Likelihood of Rehabilitation.

In light of the "Code's overriding policy favoring debtor reorganization and rehabilitation," *In re Penn Traffic Co.*, 524 F.3d 373, 383 (2d Cir. 2008), courts should not "precipitously sound the death knell for a Chapter 11 debtor by prematurely converting or dismissing the case." *In re 15375 Memorial Corp.*, 382 B.R. 652, 682 (Bankr. D. Del. 2008), *clarified* at 386 B.R. 548, *rev'd on other grounds*, 400 B.R. 420 (D. Del. 2009); *see also In re Shockley Forest Indus., Inc.*, 5 B.R. 160, 162 (Bankr. N.D. Ga. 1980) (court should not "precipitously sound the death knell for a debtor determining that the debtor's prospects for economic revival are poor") (internal citations omitted). Courts therefore "must look beyond the bare form of the debtor's filed reports and the form of its financial statements" to determine whether the moving party has carried its burden. *In re Economy Cab & Tool Co.,* 44 B.R. 721, 724 (Bankr. D. Minn. 1984) (citing cases).

[8] This figure includes over $150,000 of post-petition interest that may or may not be allowable in bankruptcy. The Debtors reserve the right to seek disallowance of that portion of the judgment that reflects pre-judgment interest that was for a time period after September 14, 2007.

Courts have thus consistently interpreted section 1112(b)(1) broadly, recognizing that the statute contemplates varied means for a debtor's rehabilitation that would return the company to good financial health, including ones that depend on contingent outcomes outside of the debtor's control. In *In re Nielsen*, for example, the court denied a creditor's motion to dismiss where the debtor owned a substantial amount of stock in a third-party company that had been forced into bankruptcy and was seeking to reorganize. 6 B.R. 82 (Bankr. N.D. Ala. 1980). Because the debtor's prospects of rehabilitation turned on the "uncertain" future of the third-party company whose fate was pending before another court, the *Nielsen* court held that the creditor moving for conversion "does not satisfy [the burden of showing] that there is an absence of a reasonable likelihood of her rehabilitation" as that question remained "inconclusive" pending the outcome of the third-party company's bankruptcy case. *Id.* at 84.

Similarly, in *In re Court Living Corp.,* the Southern District of New York affirmed a bankruptcy court's denial of a creditor's motion to convert because the debtor – a real estate corporation that owned decrepit property – argued that its prospects of rehabilitation were "linked to another debtor in another bankruptcy action" first successfully emerging from bankruptcy and renovating its adjacent property. 1996 WL 527333 (S.D.N.Y. 1996). The court concluded that "this is not a situation where the debtor is gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation" and denied a for-cause conversion under section 1112(b)(1) pending the resolution of the third-party owner's plan to repair his property. *Id.* at *4.

The three holdings underlying the district court's order regarding SCO's ownership of the UNIX intellectual property on which the Tenth Circuit will imminently rule is undeniably the hurdle blocking the rehabilitation of SCO's business. To be sure, that is why IBM and Novell

have pressed their motions to convert these cases before it is too late and SCO rehabilitates its business. The order's effects on SCO's business are undeniable. On August 10, 2007, during the hours preceding the district court's order issued that evening, SCO's stock price was $1.56, giving SCO a market capitalization of about $35.5 million. One business day later, after the decision was issued, SCO's market cap dropped almost 75% to less than $9 million, and its stock price closed at $0.44. The Movants cannot reasonably argue that a reversal of this order will not change SCO's financial position and undo effects of the order.

In addition, a reversal will permit SCO to move forward and present a compelling case to a jury. SCO will be able to present the overwhelmingly favorable extrinsic evidence that the district court disregarded on summary judgment, which includes admissions from Novell's then-Chief Executive Officer and its lead negotiator that the copyrights were in fact transferred to SCO's predecessor and that SCO owns all rights in the agreements underlying its contract claims against IBM. *See* Part I.A.4, below. On the other hand, Novell will have almost nothing to say to a jury, since its position has rested squarely on the lack of ambiguity in the contract language and a reversal would necessarily mean that the Tenth Circuit found the language ambiguous.

Even a partial reversal by the Tenth Circuit will likely have a rehabilitative effect on SCO.

First, if the Tenth Circuit reverses the district court's ruling regarding Novell's royalty rights, Novell's judgment of approximately $3.5 million against SCO will be vacated. This fact alone will result in rehabilitation, because SCO will have sufficient cash to pay all remaining creditors and to continue its business without fear of imminent shutdown by a judgment creditor.

If the Tenth Circuit reverses the money judgment, then the allowed liquidated claims against the Debtor would be about $1.5 million,[9] of which over $515,000 is owed to Boies, Schiller & Flexner LLP, which has agreed to defer payment until the litigation for which it is engaged by SCO is complete. Reversal will immediately restore the $625,000 escrow for Novell's "constructive trust" portion of the judgment. Those funds, together with the Debtors' remaining cash, will still be sufficient to pay all allowed claims in full. The Debtors can then propose a simple, non-transactional plan to pay all allowed claims in full in cash on confirmation and safely exit bankruptcy.

The Movants do not even address the results of a reversal of Novell's money judgment, much less establish the absence of a reasonable likelihood of rehabilitation following the reversal. Instead, they rely on inapposite cases such as *In re Gateway Access Solutions, Inc.*, 374 B.R. 556 (Bankr. M.D. Pa. 2007). Gateway Access Solutions was a company that owned "FCC licenses and leases to operate wireless broadband services." *Id.* at 559. Its management team consisted of one part-time owner-director-employee, Dr. Poler, and an "'acting president,' who is ill and was unable to appear at the conversion hearing, either in person or telephonically." *Id.* at 565. Dr. Poler worked "no less than six or seven days a week putting in more than eight hours on those days as an anesthesiologist, and then comes home and works another forty plus hours on rehabilitating the debtor." *Id.* Management had no time to produce business models or projections to present to the court to establish the likelihood of rehabilitation. *Id.* Moreover, the debtor produced "very few details" about its future business prospects at the trial of the conversion motion. *Id.* at 562. And the debtor called no witnesses other than Dr. Poler nor

[9] The Debtors just recently reached agreements with two of its creditors, totally eliminating one claim of approximately $15,200.00 (Lynnsoft) and greatly reducing another claim from $440,011.03 (Claim #168 of Amici LLC) to $150,000.00.

introduced any documentary evidence at the hearing to even attempt to carry its burden of proof. *Id.* at 562-63.

Unlike the situation in *Gateway*, the Debtors in these cases will provide business models and projections. They will produce witnesses who will testify to facts, and not visionary schemes, that will establish that the Debtors have a reasonable likelihood of rehabilitation. The Debtors will do this even though the burden is on the Movants to prove the opposite. *See AdBrite*, 290 B.R. at 215 ("Section 1112(b)(1) was written in the conjunctive; the movant must prove not only continuing loss to or diminution of the estate, but also must prove that there is no likelihood of rehabilitation.") (citing *In re Lizeric Realty Corp.*, 188 B.R. 499, 503 (Bankr. S.D.N.Y. 1995) (emphasis added); *see also Loop Corp. v. United States Trustee*, 290 B.R. 108, 112 (D. Minn. 2003).

Second, if the Tenth Circuit reverses the district court's ruling that Novell owns UNIX copyrights, that reversal is sure to attract customers and investors who are on the sidelines awaiting the Tenth Circuit's decision. SCO reasonably expects the following favorable results from that reversal:

- Revenues from OpenServer and UnixWare products will rise when the reversal removes the cloud over SCO's ownership of those UNIX derivatives.
- In light of the advantages (discussed below) that SCO would enjoy at a trial on this issue, there will be a substantial market for SCOsource agreements among Linux users wishing a release of claims SCO might bring based on the copyrights.
- SCO's legal claims predicated on its ownership of the copyrights will significantly increase in value.

As a result of these direct positive effects on its business, SCO also reasonably expects that investors and partners will invest in SCO after a reversal. IBM and Novell have always argued that the issues being appealed must be resolved on the contractual language alone, which Novell had previously admitted was ambiguous, to the exclusion of all extrinsic evidence. In granting Novell's motions for summary judgment, the district court agreed and disregarded the overwhelming extrinsic evidence supporting SCO, including the testimony of five former Novell executives, including its CEO and lead negotiator of the contract. *See* Part I.A.4, below. Should the Tenth Circuit find the contract ambiguous and therefore reverse, SCO will present all such extrinsic evidence. For these reasons, prospective investors and customers are awaiting a decision from the Tenth Circuit before committing resources to SCO.

Moreover, based on the foregoing results, SCO also reasonably expects that other assets of the company will increase in value. SCO reasonably expects that the value of its legal claims not predicated on ownership of the copyrights[10] will increase, because the market will understand that SCO will survive as a going concern to prosecute those claims. Similarly, SCO reasonably believes that sales of SCO's Virtualization and Mobility products, which are based on a separate, non-UNIX technology will also increase when the market understands that SCO will thus survive.[11]

For SCO customers with virtualized versions of SCO OpenServer and SCO UnixWare using Hyper-V or VMware, SCO UNIX will support the latest computer system hardware. That

[10] For example, SCO's claim against IBM for unfair competition, which is supported by a series of smoking-gun IBM documents (*see* Part I.A.5, below), does not depend in any way on a resolution of the Novell appeal, but only on SCO's continued existence as a going concern.

[11] Virtualization is one of the fastest growing and most popular trends in the IT industry today, and it is changing the computing landscape. Virtualization allows multiple operating systems to run side-by-side as peers on the same hardware server. This provides hardware cost savings and efficiency for IT departments. SCO has the opportunity to complement its product capabilities and respond to the requests of its customers by enabling its UNIX operating systems to participate in the virtualized world.

means that customers can run their existing applications and upgrade their hardware as necessary. This new product offering will allow hundreds of thousands of SCO servers to upgrade to the virtualized products on an annual recurring basis so they can continue to run their legacy applications on modern hardware.

With regard to SCO's Mobility Products, SCO recently developed, under the direction of FranklinCovey, worldwide leaders in time management, FCmobilelife Tasks by FranklinCovey. FC Tasks is an easy-to-use, feature-rich task management tool that incorporates proven planning methodology to quickly manage daily, personal, and professional tasks from an iPhone and iPod Touch. The FC Tasks application, having sold over 5,000 units in a matter of weeks, is consistently in the top 20 paid productivity applications on the Apple App Store and currently resides at number 14. A BlackBerry version is nearing completion as well and will be available on the new BlackBerry App World mobile store.

SCO's mobile strategy is to be a technology partner to create applications that SCO's business partners then market to their customer bases. The first such partnership, FranklinCovey, has produced two applications so far: FCmobilelife and FC Tasks for the iPhone, and two more iPhone applications are planned this year. FranklinCovey is marketing the solutions heavily in e-mail and web campaigns, in print catalogs to the point that FC Tasks is the cover of the current catalog, and in retail. The mobile clients on the iPhone function as stand-alone applications and will also synchronize with FCmobilelife in the future providing additional annuity subscription revenue for FCmobilelife.

SCO is, therefore, on the threshold of a break-out performance if it can get out of bankruptcy. Conversion to Chapter 7 is hardly the preferred method of doing so.

Third, if the Tenth Circuit reverses the ruling that Novell can waive critical SCO claims against IBM, SCO reasonably expects that the value of those claims will increase, as the reversal would extinguish IBM's primary defense to those claims and SCO would be one step closer to a trial of the claims. Because SCO has credible and extensive expert testimony and other evidence that these claims may be worth billions of dollars, SCO reasonably expects that a reversal would result in sizeable investments in the company. In turn, as described in the second point above, such investments would likely increase sales of SCO products as the market understands that SCO will survive as a going concern to update and support them.

Of course, if the Tenth Circuit reverses on two or all three of the issues on appeal, the foregoing positive effects on SCO's assets will synergize to further benefit the company.

The Movants do not offer any analysis of the effects a reversal would have on SCO's likelihood of rehabilitation, much less establish an absence of a reasonable likelihood of rehabilitation should the Tenth Circuit reverse. The Movants cannot meet their burden without showing that SCO is more likely than not to lose on appeal.

On the other hand, though it does not bear the burden of proof, SCO will show that even a partial reversal on appeal would result in a reasonable likelihood of rehabilitation. The appeal thus represents three independent chances for rehabilitation. In addition, neutral observers who have actually assessed the strength of the appealed-from decision agree that SCO stands to prevail on appeal. In an article entitled "Did SCO Get Linux-Mob Justice?," a former lawyer who writes for Fortune Magazine observed: "Once in a while a judicial ruling comes down that's so wrong at such a basic level that you're just left scratching your head."[12] Similarly, the online publication Managing L'unix observed: "Since [Judge] Kimball's decision to decide on disputed

[12] http://features.blogs.fortune.cnn.com/2007/09/10/did-sco-get-linux-mob-justice/.

testimony probably constitutes reversible error, this nonsense won't stand for ten seconds if the case gets to the appeals court in Denver – but between paying its lawyers and the relentless attacks on SCO (and thus on its business) by people using Groklaw, SCO may well be defeated financially before that happens."[13]

The Movants also cannot meet their burden by showing that the Tenth Circuit decision may be issued too late to result in a reasonable likelihood of rehabilitation. The Tenth Circuit has thus far handled the pending appeal on an expedited basis, setting a date for oral argument only days after SCO's initial brief was filed, and by all indications, will issue a decision promptly. A member of the panel hearing the appeal will leave the bench on August 31, 2009, thus making it highly probable a decision will issue by that date. In light of the fact that SCO can be rehabilitated by prevailing on even one of the issues on appeal and that the company could then pursue its valuable claims against IBM and Novell to the benefit of the estate, there is simply nothing to lose and everything to gain by waiting for the Tenth Circuit's decision.

3. The Nature of SCO's Claims Against IBM and Novell.[14]

Even under the district court's summary judgment rulings now on appeal, it is undisputed that SCO owns the UNIX source code and UNIX licensing business, having acquired them through a series of corporate transactions, from AT&T, to Novell, to The Santa Cruz Operation, to SCO.

UNIX is a computer software operating system. Operating systems serve as the link between computer hardware and the various software programs ("applications") that run on the computer. Operating systems allow multiple software programs to run at the same time and

[13] http://blogs.zdnet.com/Murphy/?p=1040.

[14] For a more detailed discussion of IBM's actions in support of Linux that are at the heart of SCO's claims, see Appendix A, attached hereto.

generally function as a "traffic control" system for the different software programs that run on a computer. By way of example, in the personal computing market, Microsoft Windows is the best-known operating system. The windows operating system was designed to operate on computer processors ("chip") built by Intel. Thus, Windows serves as the link between Intel-base processors and the various software applications that run our personal computers.

Since the early 1980s, the world's leading businesses and institutions have used UNIX to run servers that link networks of personal computers, process complex transactions, analyze large quantities of data, host websites, manage email, and handle e-commerce. By the mid-1990s, UNIX had become one of the most successful operating systems in the world, particularly in the area of commercial computing applications.[15]

In the business computing environment for the Fortune 1000 and other large corporations (called the "Enterprise" environment), UNIX is widely used.[16] In contrast, before IBM wrongfully transformed Linux into a competitive operating system as detailed in the Appendix hereto, Fortune 1000 companies were not using Linux for mission critical applications, such as wire transfers and satellite control systems.[17] Linux, as an operating system, simply was not capable of performing such high-level enterprise computing before IBM's improper contributions.[18]

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[15] SCO Product Licensee Summary; Appendix at 1-3.

[16] Appendix at 1-3.

[17] Appendix at 4-6, 9-10.

[18] *Id.*

The UNIX operating system was originally developed in 1969 by Dennis Ritchie, Ken Thompson and other software engineers at AT&T.[19] Starting in the 1980s, AT&T licensed UNIX for widespread enterprise use.[20] The world's major computer companies, including Hewlett-Packard, Sun Microsystems, IBM, and Sequent became some of the principal licensees.[21] These licensees used the UNIX code base to develop their own UNIX-derived "flavors" optimized for their respective computer systems.[22] IBM developed the UNIX-derivative known as AIX; Sequent, which IBM acquired in the late 1990s, developed the UNIX-derivative known as Dynix or PTX.[23]

In consideration for the competitive head-start provided to licensees by the UNIX source code that was the foundation for their UNIX flavors, AT&T's Software and Sublicensing Agreements required licensees to keep their flavors confidential, the same as the UNIX code itself.[24] Yet, in early 2000, as part of its new "Linux Strategy" aimed at transforming Linux from an "open source" program developed by a community of volunteers into a viable business alternative, IBM started publicly disclosing valuable source code and other intellectual property from AIX and Dynix – in plain violation of its Software and Sublicensing Agreements. Since AIX was derived from UNIX, the AIX source code that IBM dumped wholesale into Linux contained hundreds of thousands of lines of source code derived from UNIX. In early 2000,

[19] "New Jersey, in the muggy summer of 1969, was the birthplace of UNIX. It was born [at] AT&T's BTL (Bell Telephone Labs)." *UNIX at 25*, BYTE, 1 October 1994.

[20] SCO Product Licensee Summary; Appendix at 1-3.

[21] SCO Product Licensee Summary.

[22] May 1, 2008 Trial Transcript at 429-31; April 30, 2008 Trial Transcript at 334; December 11, 2006 Declaration of John Maciaszek ¶ 14; SCO Product Licensee Summary.

[23] January 25, 1989 Supplement No. 170 to IBM Software Agreement.

[24] *See* February 1, 1985 IBM Software Licensing Agreement SOFT-00015 ¶ 4; February 1, 1985 IBM Sublicensing Agreement SUB-00015 ¶ 4, 3.03.

IBM announced that – through its contributions of AIX – it had transformed Linux into a viable business product by creating an enterprise-class journaling file system ("JFS"), a critical component of an OS that protects data during system failures.[25] From that point on, and as a direct result of IBM's purposeful violation of its contractual obligations, SCO's revenues experienced a precipitous and steady decline.[26]

By 2003 IBM had committed vast resources to its Linux Strategy, and Novell had become a self-proclaimed "ardent supporter of Linux." [27] That year, after SCO brought suit against IBM in March, Novell announced the purchase of SuSE – a leading distributor of Linux – with a $50 million investment by IBM.[28]

In March 2003, SCO sued IBM for breach of IBM's Software and Sublicensing Agreements, copyright infringement based on IBM's continued distribution of AIX and Dynix after SCO terminated those Agreements for breach, and unfair competition in connection with a joint venture named Project Monterey. Novell then came to IBM's defense, announcing to the world that it – and not SCO – owned the UNIX copyrights upon which SCO's claims against IBM were partly predicated, and that Novell also had the unfettered right to waive IBM's violations of its Software and Sublicensing Agreements. In 2004, based on such conduct by Novell, as well as its distribution of SuSE-Linux products, SCO sued Novell for slander of title, breach of contract, unfair competition, and copyright infringement.

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[25] Appendix at 10-11; *IBM Puts Enterprise Power Behind Linux* IBM.com/press, February 2, 2002.

[26] May 19, 2006 Expert Report of Jeffrey Letizinger at 74-75.

[27] May 28, 2003 Letter from Novell to SCO at 1.

[28] March 23, 2004 Novell Press Release titled, "Novell Finalizes IBM Investment."

4. The Strength of SCO's Claims Against Novell.

Professor Christine Botosan calculated "SCO's lost profits due to Novell's public claims that SCO does not own the copyrights to the UNIX source code associated with the UNIX and UnixWare business."[29] She concluded that "SCO's lost profits are, at the lowest bound, $136.965 million, but could be as high as $215.657 million."[30]

Slander of Title.

On May 28, 2003, the day on which SCO announced its quarterly earnings and a few weeks after SCO sued IBM over violations of its Software and Sublicensing Agreements, Novell publicly claimed that it – not SCO – owned the UNIX copyrights, an assertion that Novell had not made in any context since selling the UNIX business to SCO's predecessor in 1995 under an Asset Purchase Agreement ("APA").[31] In an open letter published on its website, Novell CEO Jack Messman described Novell as "an ardent supporter of Linux" and asserted that "SCO is not the owner of the UNIX copyrights."[32]

Nine days later, after SCO had faxed a copy of Amendment No. 2 to the APA to Mr. Messman, Novell immediately issued a press release, admitting:

> Amendment #2 to the 1995 SCO-Novell Asset Purchase Agreement was sent to Novell last night by SCO. To Novell's knowledge, this amendment is not present in Novell's files. The

[29] May 29, 2007 Expert Report of Christine Botosan at 1.

[30] *Id.* Dr. Botosan deferred offering an opinion of the amount of Novell's unjust enrichment for its unfair competition until discovery pertaining to Novell's revenues from the sale of competing products was completed. In addition, SCO reserved the right to submit "additional damages analyses" pertaining to the portions of SCO's claims stayed pending arbitration, as explained below.

[31] May 28, 2008 Letter from J. Messman to D. McBride; *see also* March 26, 2007 Deposition of Maureen O'Gara at 10-13; March 23, 2004 Press Release titled "Novell Finalizes IBM Investment"; February 8, 2007 Deposition of Joseph LaSala at 58-61.

[32] May 28, 2008 Letter from J. Messman to D. McBride.

amendment appears to support SCO's claims that ownership of certain copyrights for UNIX did transfer to SCO in 1996. [33]

Within two hours of Novell's public claim that it owns the UNIX copyrights, SCO's stock plummeted, even though SCO had announced record revenues that day.[34] In discovery, SCO learned that the timing of Novell's announcement was not "entirely coincidental," as Mr. Messman had claimed.[35] Novell Vice Chairman Chris Stone had informed Maureen O'Gara, a journalist who has covered the computer industry since 1972, that Novell intentionally was making the announcement on the day of SCO's earnings report to "confound SCO's stock position" and "upset the stock price."[36] According to her testimony, Mr. Stone leaked this information "with laughter" and "chortling."[37]

In January 2004, SCO sued Novell for slander of title to the UNIX copyrights. On Novell's motion for summary judgment, the district court dismissed that claim, ruling that Novell had retained the copyrights under the APA. The court reasoned that neither the original APA nor Amendment No. 2 to the APA, each standing alone, transferred the copyrights to Santa Cruz. SCO appealed the ruling, arguing that the district court erred in reading the APA and Amendment No. 2 as separate and distinct documents and that when properly read together, as required by basic rules of construction, they provide for the transfer of copyrights.

The APA identifies "all of Seller's right, title, and interest in and to the assets" listed in the Assets Schedule, and not listed in the Excluded Assets Schedule, as assets transferred in the

[33] June 6, 2003 Press Release titled "Novell Statement on SCO Contract Amendment" (emphasis added).

[34] May 18, 2007 Declaration of Christine Botosan ¶¶ 6-9.

[35] June 12, 2003 Letter from D. McBride to J. LaSala; March 26, 2007 Deposition of Maureen O' Gara at 6-13 and 22-25.

[36] March 26, 2007 Deposition of Maureen O'Gara at 6-13 and 22-25.

[37] *Id.* at 22-25.

transaction.[38] Item I of the Assets Schedule summarizes the transferred "assets and properties of Seller" as "All rights and ownership of UNIX, UnixWare and Auxiliary Products, including but not limited to" the assets and properties listed in the Schedule, "without limitation."[39] The schedule then lists all source code and binary code versions of UNIX.[40] Item V.A of the Excluded Assets Schedule, as amended by Amendment No. 2, identifies:

> All copyrights and trademarks, except for the copyrights and trademarks owned by Novell as of the date of the Agreement required for SCO to exercise its rights with respect to the acquisition of UNIX and UnixWare technologies.[41]

Prior to Amendment No. 2, Item V.A excluded: "All copyrights and trademarks, except for the trademarks UNIX and UnixWare."[42] But Amendment No. 2 expressly excised that language from the APA by stating that "Subsection A [of Item V] shall be revised to read" the language set forth in the Amendment.[43]

Robert Frankenberg, President and CEO of Novell at the time of the APA, testified that it was his "initial intent," his "intent at the time when the APA was signed," and his "intent when that transaction closed" that "Novell would transfer the copyrights to UNIX and UnixWare technology to Santa Cruz" and that "that intent never changed."[44] Ed Chatlos, who served as Novell's lead negotiator for the asset purchase and who participated in "detailed discussions"

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[38] APA at 1.

[39] APA at Schedule 1.1(a); Amendment No. 1 to the APA at 7.

[40] APA at Schedule 1.1(a).

[41] Amendment No. 2 to the APA

[42] APA at Schedule 1.1(b).

[43] Amendment No. 2 to the APA.

[44] February 10, 2007 Deposition of Robert Frankenberg at 134-37.

with Santa Cruz lead negotiator Jim Wilt, testified to the same intent to sell the copyrights to Santa Cruz as part of the transaction.[45] In all, the following ten witnesses testified to the same intent without any qualification:

| NOVELL SIDE | SANTA CRUZ SIDE |
|---|---|
| **Robert Frankenberg**, President and CEO[46] | **Alok Mohan**, President and CEO[47] |
| **Ed Chatlos**, Senior Director for UNIX Strategic Partnerships and Business Development and Lead Negotiator of the APA[48] | **Jim Wilt**, Vice President and Lead Negotiator of the APA[49] |
| **Duff Thompson**, Senior Vice President[50] | **Doug Michels**, Founder and Vice President[51] |
| **Burt Levine**, In-House Counsel[52] | **Steven Sabbath**, General Counsel[53] |

[45] October 1, 2004 Declaration of Ed Chatlos ¶¶ 9-11; March 22, 2007 Deposition of Ed Chatlos at 34-41.

[46] February 10, 2007 Deposition of Robert Frankenberg at 134-37.

[47] February 7, 2007 Deposition of Alok Mohan at 138-41.

[48] October 1, 2004 Declaration of Ed Chatlos ¶¶ 9-11; March 22, 2007 Deposition of Ed Chatlos at 34-41.

[49] January 26, 2007 Deposition of James Wilt at 26-29 and 74-77.

[50] February 9, 2006 Deposition of Duff Thompson at 130-133.

[51] March 28, 2007 Deposition of Douglas Michels at 134-41.

[52] March 23, 2007 Deposition of Burt Levine at 66-69 and 154-61.

[53] February 12, 2007 Deposition of Steven Sabbath at 22-25 and 218-25.

| | |
|---|---|
| **Ty Mattingly**, Vice President for Strategic Relations[54] | **Kimberlee Madsen**, Assistant Negotiator[55] |

Other extrinsic evidence, including repeated admissions by Novell, confirms that the parties intended to transfer the copyrights to Santa Cruz. Contemporaneous with the APA, Novell:

- Transferred its UNIX copyright registrations to Santa Cruz, which transferred them to SCO in 2001.[56] SCO has possession of the registrations.[57]
- Modified the copyright notices on the UNIX source code existing at the time of the APA to reflect the change in ownership of the copyrights from Novell to Santa Cruz.[58]
- Reported to the APA transition team that "the following changes have been made" to existing UNIX code at the request of Santa Cruz: "SCO copyrights added to documentation and software."[59]
- Admitted that "All of the technology and intellectual assets" in existing UNIX source code "will be transitioned to SCO sometime after December 1, 1995."[60]

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[54] January 19, 2007 Deposition of Ty Mattingly at 26-33.

[55] November 4, 2006 Declaration of Kim Madsen ¶¶ 9-11, 16; February 13, 2007 Deposition of Kim Madsen at 70-81.

[56] *See, e.g.*, Copyright Registration TXU 516 704; Copyright Registration TXU 516 705.

[57] *Id.*

[58] May 18, 2007 Declaration of Sandeep Gupta.

[59] UnixWare 2.1 Statement of Work at 2.

[60] November 16, 1995 Statement of Work for UNIX95 at 3; November 22, 1995 Statement of Work for Post-Eiger C++ at 2.

- Announced in a joint press release that "SCO will acquire Novell's UnixWare business and UNIX intellectual property."[61]
- Notified its customers that Novell had transferred "its existing ownership interest in UNIX System-based offerings and related products" to Santa Cruz and referred to Santa Cruz as "the owner" of the UNIX software.[62] These UNIX assets were identified as "All Releases of UNIX System V and prior Releases of the UNIX System."[63]
- Admitted that Santa Cruz had purchased the UNIX business "lock, stock and barrel."[64]

Contemporaneous with the APA and its amendments, Santa Cruz:

- Shipped countless UnixWare products with a Santa Cruz copyright notice on the product discs, without objection from Novell.[65]
- Announced in its 1995 Annual Report that it had acquired "certain assets related to the UNIX business including the core intellectual property from Novell."[66] Wilson Sonsini, the law firm that represented Novell in the APA, was Santa Cruz's counsel in connection with the 1995 Annual Report.[67]

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[61] September 20, 1995 Joint Press Release at 2.

[62] *See, e.g.*, March 25, 1996 Letter from Novell to Prentice Hall; April 11, 1996 Letter from Novell to Intel Corp.; February 13, 1996 Letter from Novell to International Computers Ltd.; January 22, 1996 Letter from M. DeFazio to Microsoft Corp.; April 11, 1996 Letter from M. Negishi to Intel Corporation; February 3, 1996 Letter from S. Jonas to International Computer Limited; March 25, 1996 Letter from M. Negishi to Prentice Hall, Inc.

[63] March 25, 1996 Letter from M. Negishi to Prentice Hall, Inc. at 3.

[64] October 18, 1995 Email from L. Bouffard.

[65] *See, e.g.*, November 10, 2006 Declaration of Jay Peterson ¶ 3; SCO UnixWare 2.1 CD; SCO UnixWare 2.1.3 Update CD.

[66] Minutes of Meeting of Board of Directors on 1995 Annual Report at 2 (emphasis added).

- Stated through its investment banker that, under the APA, Santa Cruz "will obtain the IP" for UNIX, UnixWare, and all UNIX-related products.[68]
- Recited in a 1998 agreement with Microsoft that "SCO has acquired AT&T's ownership of the copyright in the UNIX System V operating system."[69]
- As UNIX copyright holder, brought a complaint against Microsoft before the European Commission in 1997, representing that it had "acquired ownership of the copyright to UNIX," and referring to itself as "the copyright owner of UNIX."[70]

Novell's only response to this overwhelming evidence has been to argue that it must be excluded wholesale because it supposedly contradicts the plain language of the original, un-amended APA.[71] That is a non-sequitur. The evidence does not contradict, but rather confirms, the plain language of the operative APA, which plainly provides for the transfer of "All rights and ownership" of UNIX and UnixWare, including specifically the set of copyrights identified in Amendment No. 2.

Breach of Contract and Unfair Competition.

SCO also brought claims against Novell for breach of contract and unfair competition based in part on Novell's wrongful exercise of its rights under Article 4.16(b) of the APA in defense of IBM. For its part, Novell sought a declaration that its Article 4.16(b) rights extend to

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[67] September 1, 1995 Letter from Barry Taylor to Steven Sabbath at 1-2; Minutes of Meeting of Board of Directors on 1995 Annual Report at 36.

[68] Project Sleighride Presentation at 5 (emphasis added).

[69] May 29, 1998 Settlement Agreement Between SCO and Microsoft.

[70] January 31, 1997 SCO European Union Complaint at §§ 4.9, 3.4, and 8.1.

[71] *See* April 9, 2009 Appellee Novell Inc.'s Brief at 31-33.

SCO's contract claims against IBM. The district court granted Novell's motion for summary judgment on this issue, concluding that Novell's right extended to Software and Sublicensing Agreements and thus Novell had the right to waive SCO's contract claims against IBM. Should the Tenth Circuit reverse that ruling, SCO will be able to pursue those claims in the *SCO v. IBM* litigation.

Article 4.16(b) grants Novell the right to "amend, supplement, modify or waive any rights" under certain licenses called "SVRX Licenses" in the APA.[72] The scope of Novell's rights therefore turns on the meaning of the term "SVRX Licenses" as used in the contract. Novell argued, and the district court on summary judgment ruled, that the term "SVRX Licenses" unambiguously includes IBM's Software and Sublicensing Agreements. But that is not what the APA provides.

Article 4.16(a) identifies the "SVRX Licenses" by pointing to a list in Item VI of the Assets Schedule:

> Following the Closing, Buyer shall administer the collection of all royalties, fees and other amounts due under the SVRX Licenses (as listed in detail under Item VI of Schedule 1.1(a) hereof and referred to herein as "SVRX Royalties).[73]

In turn, the introductory sentence of Item VI also refers to a forthcoming list of SVRX Licenses:

> All contracts relating to the SVRX Licenses and Auxiliary Product Licenses (collectively "SVRX Licenses") listed below:[74]

The ensuing list in Item VI, however, is a list of products, not a list of licenses.[75]

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[72] APA at 24.

[73] *Id.* (emphasis added).

[74] APA at Schedule 1.1(a); Amendment No. 1 to the APA at 9 (emphasis added).

[75] APA at Schedule 1.1(a); Amendment No.1 to APA at Attachment A.

Looking to the introductory sentence of Item IV instead of the list thereunder, the district court ruled (at 80-81 and 88) that the term "SVRX Licenses" unambiguously includes "all contracts relating to SVRX," including Software and Sublicensing Agreements. But the term "SVRX Licenses" is obviously ambiguous, as it is not defined, except in a circular reference to itself that runs into a dead-end. The "SVRX Licenses" are defined as a list of "SVRX Licenses" that is supposed to appear in Item VI, but that does not appear anywhere in the APA. The district court (at 78) acknowledged that there "appears to be some ambiguity in the APA's attempt to define SVRX Licenses," but decided to resolve the ambiguity on summary judgment anyway – by taking an "inferential step" (at 78) in favor of Novell, the moving party.

In addition, the district court confused the introductory sentence of Item VI with the list that appears under that sentence. Like all other Items in the Asset Schedule, Item VI identified assets being transferred to Santa Cruz under the APA. In that context, Item VI identifies "all contracts relating to the SVRX Licenses" listed below it as assets that Santa Cruz was purchasing.[76] Instead of independently listing the "SVRX Licenses" over which Novell was retaining waiver rights, Article 4.16 cross-referenced a portion of Item VI – the list.[77] By its own terms, the clear language of Article 4.16 applies only to the SVRX Licenses "listed below" the introductory sentence of Item VI – not to "all contracts relating to" the list.

Finally, the Software and Sublicensing Agreements, such as those executed by IBM, are separately listed as assets sold to Santa Cruz without any reservation of rights for Novell, under Item III of the Assets Schedule:

> All of Seller's rights pertaining to UNIX and UnixWare under any software development contracts, licenses and any other contracts to

[76] APA at Schedule 1.1(a); Amendment No. 1 to APA at 9.

[77] APA at 24 (describing the SVRX Licenses as being "listed in detail under Item VI of Schedule 1.1(a)").

> which Seller is a party or by which it is bound and which pertain to the Business . . . including without limitation . . . Software and Sublicensing Agreements.[78]

The district court's conclusion that the "SVRX Licenses" in Item VI include the Software and Sublicensing Agreements expressly sold under a separate Item would thus mean that the APA transferred the Software and Sublicensing Agreements twice.[79] Since those Agreements are already transferred by name in Item III, the term "SVRX Licenses" in Item VI cannot properly be read to include the Agreements.

Messrs. Frankenberg, Chatlos, Thompson, Mattingly, Mohan, Wilt, Michels, and Sabbath, and Ms. Madsen all testified that Article 4.16(b) was not intended to apply to Software and Sublicensing Agreements.[80] William Broderick and John Maciaszek, executives in Novell's UNIX licensing group, specifically testified that Novell used the term "SVRX Licenses" to refer to other agreements that Novell and AT&T used in licensing individual SVRX products under the terms of the Software and Sublicensing Agreements.[81]

SCO also showed that Novell and Santa Cruz previously resolved in SCO's favor the very same dispute concerning the scope of the Article 4.16(b) rights. In April 1996, without informing Santa Cruz, Novell and IBM entered into a so-called amendment of IBM's Software and Sublicensing Agreements granting IBM limited rights to distribute AIX source code.[82]

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[78] APA at Schedule 1.1(a) (emphasis added).

[79] August 10, 2007 Memorandum Decision and Order of Judge Kimball at 81, 88, and 100.

[80] February 10, 2007 Deposition of Robert Frankenberg at 134-137; October 1, 2004 Declaration of Ed Chatlos ¶ 13; November 9, 2006 Declaration of Duff Thompson at ¶ 7; January 19, 2007 Deposition of Ty Mattingly at 50-53; November 9, 2006 Declaration of Alok Mohan at ¶ 4; November 23, 2004 Declaration of Jim Wilt at ¶ 10; November 9, 2006 Declaration of Doug Michels at ¶¶ 4-5; November 4, 2006 Declaration of Kim Madsen at ¶ 13.

[81] December 11, 2006 Declaration of John Maciaszek at ¶¶ 10-14; December 11, 2006 Declaration of William Broderick at ¶¶ 13-17.

[82] April 26, 1996 Amendment to IBM Software and Sublicensing Agreement.

When Santa Cruz learned of the unauthorized amendment, it immediately objected, asserting to Novell that "our agreements provide SCO with ownership and exclusive rights to license the UNIX source code."[83] Santa Cruz further wrote: "As to source code, Novell must recognize that it has no interest whatsoever and must not engage in any . . . grant of expanded rights."[84]

Novell's CEO, Mr. Frankenberg, did not challenge those assertions, and indeed, over the ensuing six months of negotiations, Novell did not once invoke its Article 4.16(b) rights, as it did in 2003.[85] Instead, Novell and Santa Cruz resolved the issue by executing Amendment No. 2 to the APA and two related agreements. Pursuant to this resolution, Novell paid Santa Cruz $1.5 million for a release of claims against Novell for its execution of the unauthorized amendment[86] and Novell also agreed that it "may not prevent SCO from exercising its rights with respect to SVRX source code in accordance with" the APA.[87]

Copyright Infringement Claim.

SCO also brought a claim for copyright infringement against Novell based on its distribution of Linux products through its wholly owned subsidiary SuSE Linux, which Novell acquired in 2004 with a $50 million investment by IBM.[88] In addition, Novell's distribution of Linux was also a partial basis for SCO's breach of contract and unfair competition claims. The

[83] April 23, 1996 Letter from A. Mohan to R. Frankenberg.

[84] July 15, 1996 Letter from A. Mohan to J. Tolonen.

[85] April 19, 1996 Letter from R. Frankenberg to A. Mohan; March 28, 1996 Letter from Mohan to Frankenberg; July 9-15, 1996 Letters between A. Mohan and J. Tolonen regarding IBM Buyout.

[86] October 16, 1996 General Release of Claims Agreement between Novell and Santa Cruz.

[87] Amendment No. 2 to APA at 1.

[88] March 23, 2004 Novell Press Release titled, "Novell Finalizes IBM Investment."

district court stayed those portions of those claims as well as the copyright infringement claim pending arbitration.

5. The Strength of SCO's Claims Against IBM.

SCO brought claims against IBM for breach of its Software and Sublicensing Agreements based on IBM's contributions of AIX and Dynix to Linux development, copyright infringement based on IBM's continued distribution of AIX and Dynix after SCO terminated those Agreements for breach, unfair competition in connection with a joint venture named Project Monterey, and interference with contracts and business relationships. SCO also came to pursue a claim for copyright infringement based on IBM's activities in support of Linux.

In May 2006, Dr. Jeffrey Leitzinger concluded that "IBM has received over $12 billion in Linux-related revenues and over $4 billion in Linux-related profits" since 2000.[89]

Dr. Leitzinger also concluded at that time that "SCO lost $753 million in profits and ongoing business value" since 2000, "in connection with IBM's unauthorized disclosures of SCO's intellectual property, technology, methods and concepts."[90] Consistent with Dr. Leitzinger's opinion, Professor Avner Kalay, another expert, concluded that "the market value of the asset that SCO lost through the alleged breach of contract by IBM" was "between a low of $597,845,000 and a high of $717,414,000" at the onset of the breach in February 2000.[91]

As to damages resulting from IBM's unauthorized distribution of AIX after the termination of its Software and Sublicensing Agreements, Professor Christine Botosan concluded that "IBM generated actual AIX related revenues of $9,373.51 million during the

[89] May 19, 2006 Expert Report of Jeffrey Leitzinger at 58.

[90] *Id.* at 62.

[91] May 19, 2006 Expert Report of Avner Kalay at 39.

Post-Termination Period ending December 31, 2005. If the Post-Termination Period is extended to include 2006, my estimate of IBM's AIX related revenues rises to $13,573.51 million."[92] Professor Botosan also concluded that "IBM generated actual AIX related gross profits of $4,979.94 million during the Post-Termination Period ending December 31, 2005. If the Post-Termination Period is extended to include 2006, my estimate of IBM's AIX related gross profits rises to $7,210.03 million."[93]

In addressing damages resulting from IBM's misuse of SCO code provided in Project Monterey, Professor Botosan concluded that "IBM generated actual AIX related revenues of $9,490.55 million" and "AIX related profits of $4,694.82 million," between October 1, 2000 and June 13, 2003, the date SCO terminated IBM's Software and Sublicensing Agreements.[94] Professor Botosan calculated damages only through June 13, 2003, to avoid double-counting damages already included in her analysis of the copyright infringement claim for AIX.

Contract Claims.

AT&T's legal department created a Software Agreement and a Sublicensing Agreement that imposed strict requirements on licensees' use, export, transfer, and disclosure of the UNIX-derived software.[95] The cornerstones of these protections were Sections 7.06(a) and 2.01 of the Software Agreement. Section 7.06(a) of the Agreement states in relevant part:

> LICENSEE agrees that it shall hold all parts of the SOFTWARE PRODUCTS subject to this Agreement in confidence for AT&T. LICENSEE further agrees that it shall not make any disclosure of

[92] May 19, 2006 Expert Report of Christine Botosan at 2.

[93] *Id.*

[94] *Id.* at 12.

[95] *See, e.g.*, February 1, 1985 IBM Software Licensing Agreement SOFT-00015 §§ 2.01, 7.06; February 1, 1985 IBM Sublicensing Agreement SUB-00015A ¶ 4.

> any or all of such SOFTWARE PRODUCTS (including methods or concepts utilized therein) to anyone, except to employees of LICENSEE to whom such disclosure is necessary to the use for which rights are granted hereunder.

The Software Agreement thus extended its protections not only to the literal source code in which the UNIX innovations had been originally expressed, but also to "all parts" of the licensed UNIX product, including expressly the "methods and concepts" embodied in the software. Several witnesses, including some on whose testimony IBM relied, confirmed that these protections were intended to extend beyond the literal code, to the ideas, structures, sequences, organizations, methods, and concepts embodied therein.[96]

Section 2.01 of the Software Agreement provides:

> AT&T grants to LICENSEE a personal, nontransferable and nonexclusive right to use in the United States each SOFTWARE PRODUCT identified in the one or more Supplements hereto, solely for LICENSEE'S own internal business purposes and solely on or in conjunction with DESIGNATED CPUs for such SOFTWARE PRODUCT. Such right to use includes the right to modify such SOFTWARE PRODUCT and to prepare derivative works based on such SOFTWARE PRODUCT, provided the resulting materials are treated hereunder as part of the original SOFTWARE PRODUCT.

Accordingly, if a licensee exercised its right under its Software Agreement to rely on the original UNIX product in preparing a derivative work such as AIX or Dynix, then the licensee had to afford such "resulting materials" the same strict protections required by the Software Agreement for the original UNIX product itself. All the restrictions in the Software Agreement that applied

[96] November 15, 2004 Deposition of Geoffrey Green at 130-31; August 25, 2006 Deposition of Otis Wilson at 120, 128; October 2, 2006 Declaration of William Guffey ¶¶ 3-10; June 8, 2004 Deposition of David Frasure at 18-19, 178; November 12, 2004 Declaration of Ira Kistenberg ¶¶ 5-6; Declaration of William Murphy ¶¶ 2-15; Deposition of Burt Levine at 40-41; Letters from Otis Wilson to UNIX licensees (attached as Exs. 27-29 and 36 to November 11, 2006 SCO Memorandum in Opposition to IBM Motion for Summary Judgment on SCO's Contract Claims).

to the original UNIX product – including the confidentiality restriction of Section 7.06(a) – also applied to derivative works such as AIX and Dynix.

SCO also brought claims against IBM for breach of its Sublicensing Agreements. IBM's Sublicensing Agreements authorized it to distribute binary-code versions of its UNIX-derivative products – AIX and Dynix – provided that IBM complied with the requirements of the Software Agreements.[97] In light of IBM's breaches of its Software Agreements, SCO terminated IBM's Sublicensing Agreements in 2003. When IBM continued thereafter to distribute AIX and Dynix, SCO brought claims for breach of the Sublicensing Agreements based on those ongoing distributions.

IBM has not disputed the facts that underlie SCO's contract claims: AIX and Dynix are UNIX-derivative works, and IBM dumped substantial portions of AIX and Dynix into Linux and disclosed the methods and concepts found in UNIX, AIX, and Dynix in developing Linux.[98]

Instead of disputing these facts, IBM has primarily argued that the protections in the Software Agreement apply only to the literal source code from the licensed UNIX product, and not to the methods and concepts and other intellectual property embodied in the code, or to any part of code physically written by IBM or Sequent in developing AIX and Dynix.[99] That is not remotely what the Software Agreement says, and IBM's interpretation gives no meaning to entire provisions. Section 2.01 required IBM to use the UNIX product "solely for [its] own internal business purposes" on specified CPUs, and Section 7.06(a) required IBM to keep "all parts" of the UNIX software confidential, including specifically the "methods and concepts"

[97] *See, e.g.*, February 1, 1985 IBM Software Licensing Agreement SOFT-00015 §§ 2.01, 7.06; February 1, 1985 IBM Sublicensing Agreement SUB-00015A ¶ 4.

[98] *See* November 25, 2006 Memorandum in Support of IBM's Motion for Summary Judgment on SCO's Contract Claims.

[99] *Id.* at 1-5, 80.

embodied in the source code. Section 2.01 authorized use of the original UNIX product to develop AIX and Dynix on the condition that IBM afford them – the "resulting materials" – the same protections afforded to the "original UNIX product." The restrictions Sections 2.01 and 7.06(a) and other sections of the Software Agreement plainly apply with the same force to "all parts" of AIX and Dynix, including methods and concepts.

Copyright Infringement.

SCO also brought a claim for copyright infringement against IBM based on its continuing copying and distribution of AIX, after SCO terminated the Sublicensing Agreements authorizing IBM to conduct such activities. Based on a comprehensive and detailed expert analysis of the two operating systems, SCO established that AIX is a derivative of System V Release 4 ("SVR4") under the meaning of the Copyright Act:

- In addition to the fact that over 440,000 lines of source code in AIX are literally copied from SVr4, IBM itself placed "Origin Codes" on 179 files in AIX to signify that the files were derived from UNIX System V. Those files form the most important part of the AIX kernel. They form the heart of AIX functionality; it is impossible for AIX to function on any level without them.[100]

- The structure of AIX 4.3 is substantially similar to the structure of SVr4. AIX includes approximately 90% of the SVr4 system calls. In addition, AIX brings together several elements in a manner similar to SVr4, such as the system calls, file system, shared memory, sockets, files, and pipes, as well as the fact that AIX is structured as a monolithic kernel. [101]

- The structure of AIX 5.3 is substantially similar to the structure of SVr4 in the same way as AIX 4.3, which compels the inference that all versions of AIX

[100] *See* Expert Report of Dr. Thomas A. Cargill at 61-84; Expert Rebuttal Report of Dr. Thomas A. Cargill at 34-36; July 17, 2006 Cargill Report in Response to Report of Brian Kernighan at 34; May 19, 2006 Mark J. Rochkind Expert Report; August 26, 2006 Mark J. Rochkind Rebuttal Report; November 9, 2006 Declaration of Thomas A. Cargill.

[101] *See Id.*

between those two versions share the same similarity in system calls and structure.[102]

SCO also came to pursue a copyright infringement claim against IBM based on IBM's activities promoting Linux. Based on another comprehensive and detailed expert analysis, SCO established that Linux is a derivative of SVR4 under the meaning of the Copyright Act.[103] SCO also submitted abundant evidence confirming that conclusion, including:

- Dr. Thomas Cargill concluded that "it would be an astonishing coincidence if the selection, arrangement, and coordination of elements in Linux were developed independently from the remarkably similar selection, arrangement, and coordination of elements in SVr4."[104]

- Linux was developed through systematic copying of SCO's copyrighted material. Linux Torvalds, the person who conceived Linux, started with a "UNIX variant."[105] He then referred to the manuals for the Sun Microsystems version of UNIX: "That's how early development was done. I was reading the standards from either the Sun OS manual or various books, just picking off system calls one by one and trying to make something that worked."[106]

IBM has repeatedly admitted that Linux is a derivative of UNIX:

- In a presentation touting the UNIX-derived strengths of Linux, IBM admitted that "UNIX was a pre-write to Linux" and that Linux is "a UNIX-like operating system."[107]

- IBM described Linux as "an independent UNIX OS implementation, that complies with the standard specifications that define the basic UNIX

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[102] *See Id.*

[103] Expert Report of Dr. Thomas A. Cargill at 64-65; September 9, 2006 Deposition of Brian Kernighan at 135:4-6.

[104] Expert Report of Dr. Thomas A. Cargill at 64.

[105] *Just for Fun "The Story of an Accidental Revolutionary."* By Linus Torvalds at 61.

[106] *Id.* at 82.

[107] November 7, 2004 Power Linux Review at 7.

environment,"[108] as a "community-developed version of UNIX," or simply as "derived from UNIX."[109]

IBM has also repeatedly admitted that it copies Linux onto its machines, contributes to the Linux code base, and provides and promotes Linux products and services – all violations of the Copyright Act if SCO is found to be the owner of the relevant UNIX copyrights.[110] Instead of disputing that it has engaged in its undeniable Linux-related activities, IBM has primarily argued that SCO is not the owner of the relevant UNIX copyrights because Novell retained them under the Asset Purchase Agreement by which it transferred the UNIX business to Santa Cruz, SCO's predecessor, in 1995 (the "APA").

Unfair Competition.[111]

SCO's unfair competition claim was based primarily on IBM's conduct in connection with Project Monterey, which was supposed to be a joint venture between IBM and Santa Cruz to develop a UNIX-based operating system and related products for a new Intel 64-bit chip in the late 1990s. Through a trail of smoking-gun e-mails and other IBM internal documents, SCO showed that IBM made a conscious decision to abandon the project, concentrate instead on a competing Linux solution, and keep SCO in the dark about this decision. IBM led SCO to believe that IBM intended to continue the project to the benefit of both partners. This deprived SCO of the opportunity to find other partners, to upgrade its UNIX products to compete with Linux, and to avoid wasting the company's resources on Project Monterey.

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[108] 181437809; *see also* 1710009766. (SCO herein cites to a few sources by the Bates Number used in the *SCO v. IBM* litigation, where it would be impractical to cite the source by name or description.)

[109] 1710090717, 181422027,181520961, 181011201.

[110] *See, e.g.*, Appendix at 10-12.

[111] IBM has designated as confidential the smoking-gun documents and other IBM documents underlying this claim. SCO refers the Court to SCO's September 25, 2006 memorandum in opposition to IBM's motion for summary judgment on this claim for the evidentiary support for the claim.

In addition, by thus stringing SCO along, IBM deceptively obtained access to SCO's valuable SVR4 source code and then used that source code to improve IBM's competing AIX 5L for Power operating system. IBM then attempted to cover up its scheme and perfect is contractual rights to use the SVR4 code under the partnership agreement, by making a nonfunctional, sham version of the Monterey operating system. Again SCO submitted a trail of internal IBM documents that leave no doubt about IBM's conduct and motives.[112]

### B. Cause" Does Not Exist Under Section 1112(b)(4)(B) Because the Estates Have Not Been Grossly Mismanaged.

It is no secret that the Debtors filed bankruptcy, among other reasons, to stay alive long enough to allow SCO to prosecute an appeal of a seriously prejudicial ruling by the district court in Utah. The ruling confronted SCO with three daunting problems that made it likely that it would not survive long enough to vindicate its rights. First, the district court "found" that SCO never owned, because its predecessor never bought, the copyrights that underlie SCO's major UNIX. This ruling spooked SCO's customers and prospective customers, and forms a large part of why the Debtors have since suffered losses. Second, the district court found that SCO's assets should be impressed with a constructive trust in Novell's favor because of Novell's claim that SCO committed conversion and breach of a fiduciary duty to Novell by collecting revenues generated by its licensing of UNIX to Sun Microsystems and Microsoft Corporation after 2003. Novell argued that SCO collected about $30 million from these sources. A ruling that SCO's cash at that time of $6.8 million was impressed with a constructive trust would have frozen all of SCO's cash, thus putting it out of business instantly. Finally, the trial court denied SCO the right

[112] SCO also brought interference claims alleging that IBM caused UNIX licensees to violate their licensing agreements with SCO to migrate their computer operations to Linux and that IBM, in response to SCO's efforts to protect its contract and intellectual property rights, also induced companies to discontinue existing and potential business relationships with SCO. In addition, SCO brought an interference claim alleging that IBM induced Novell to breach the APA by asserting ownership of the UNIX copyrights and rights to waive SCO's contract claims against IBM.

to immediately appeal the ruling at that time, leaving SCO no hope for relief outside Chapter 11. The decision to file Chapter 11 was really the only option management of the Debtor had.

The easy road for management, then, was to file a simple plan that would allow the Debtors to continue to operate through appeal: a successful appeal would lead to prompt payment in full to trade vendors and the holders of other undisputed or ultimately allowed claims; an unsuccessful appeal would present a different decision tree.[113]

But management of a debtor in Chapter 11 owes a fiduciary duty to its creditors as well as shareholders. It cannot ignore bona fide purchase offers that would provide immediate cash to creditors while preserving valuable litigation assets for shareholders. Hence SCO management pursued the York deal. True, the York deal foundered on insecurity regarding what SCO owned and could sell. Without dwelling on the unhappy details, SCO attempted a similar effort, again unsuccessfully, with SNCP. Management's efforts to consummate a sale, albeit unsuccessful, clearly proceeded with the interests of both creditors and shareholders foremost in mind.

In the meantime, as cash dwindled, management made the proper decisions. It reduced staffing, sold excess assets, downsized facilities and reduced infrastructure, limited new product development activities, and significantly reduced other operating costs. Management has done what any good management team would and should do under like circumstances. Its choice to take such action is not mismanagement, gross or otherwise.

Although the court's decision in 15375 Memorial Corp., 382 B.R. 652, that the movant had failed to prove gross mismanagement as a ground for dismissal, was not the issue on appeal. The court's analysis on the unaffected issue is à propos here.

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[113] Even if the appeal should fail, significant claims against IBM remain, worth at least hundreds of millions of dollars.

In the bigger picture, management has successfully navigated an exceedingly difficult situation. Management has kept the Debtors alive and just a few weeks away from potential vindication and reinvigoration.

### C. "Cause" Does Not Exist Under Section 1112(b)(4)(J) Because That Subsection Does Not Apply.

Title 11[114] fixes a deadline to file a disclosure statement and a plan in only one circumstance: It fixes a deadline of 300 days after the date of the order for relief for a small business debtor to file a plan and a disclosure statement. 11 U.S.C. § 1121(e)(2). This section of the Bankruptcy Code was added in 2005 as part of BAPCPA. Its purpose is solely related to a statutory "small business debtor."[115]

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[114] Because Section 1112 applies to cases in Chapter 11 only, the reference in Section 1112(b)(4)(J) to "this title" (meaning "title 11") is overbroad. Also, since the section addresses the failure to file a disclosure statement – something that can only occur in a Chapter11 case in the first place, the subsection should probably have been worded to say: "failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by the provisions of this chapter or by order of the court."

[115] In *In re Coleman Enterprises, Inc.*, 266 B.R. 423, 430-31 (Bankr. D. Minn. 2001), the court explained the purpose of the original version of the deadline for small business cases as follows:

> In the Bankruptcy Reform Act of 1994, Pub.L. No. 103-394, Congress amended several provisions of Chapter 11 to create a variant of the process to obtain confirmation of a plan of reorganization. These changes were collected in Section 217 of the Act; they were to apply to cases where the debtor is a "small business," as defined. Very little legislative history accompanied the enactment. Congress did announce, however, that the amendments were passed "to expedite the process by which small businesses may reorganize under Chapter11." Floor Statements on the Bankruptcy Reform Act of 1994, 140 CONG. REC. H 10,764, H 10,768 (Daily ed. October 4, 1994) (analysis of Act's provisions appended to remarks of Rep. Brooks).

With respect to BAPCPA, commentary by the Honorable Joe Lee teaches that:

> Section 437 of the Act (BAPCPA] amends section 1121(e) of the Bankruptcy Code with respect to the period of time within which a small business debtor must file and confirm a plan of reorganization. This provision provides that a small business debtor's exclusive period to file a plan is 180 days from the date of the order for relief, unless the period is extended after notice and a hearing, or the court, for cause, orders otherwise. It further provides that a small business debtor must file a plan and any disclosure statement not later than 300 days after the order for relief.

Bankruptcy Service, Lawyers Edition, 5 Bankr. Service L. Ed. § 44:2 (Updated April 2009) (emphasis added).

Moreover, although the Court has extended the Debtors' exclusive periods on a number of occasions, the concept of exclusivity does not impose a deadline on the debtor, but merely bars others from filing a plan prematurely. Removing a debtor's exclusive right to file a plan does not affect its right of to file a plan. *In re Parker Street Florist & Garden Center*, 31 B.R. 206, 207 (Bankr. D. Mass. 1983) ("The fact that the debtor no longer has the exclusive right to file a plan does not affect its concurrent right to file a plan. Denying such a motion [to extend exclusivity] only affords creditors their right to file a plan; there is no negative affect [sic] upon the debtor's coexisting right to file its plan."); *see also In re Grossinger's Assocs.*, 116 B.R. 34, 36 (Bankr. S.D.N.Y. 1990) ("loss of plan exclusivity does not mean that the debtor is foreclosed from promulgating a meaningful plan of reorganization; only that the right to propose a Chapter 11 plan will not be exclusive with the Debtor"). The United States Trustee Manual teaches that 11 U.S.C. § 1121(b) and (e), which establish the exclusive period within which only the debtor may file a plan, do not impose any requirement that the debtor actually file a plan or suffer specific consequences." UST Manual Volume 3 Chapter 9: Monitoring the Case, ¶ 3-9.4.6. Finally, the Court has not entered an order fixing a deadline for the Debtors to confirm a plan. Simply put, this subsection does not apply.

Because "cause" does not exist, these Motions should be denied.

## II. THE MOTIONS CAN ALSO BE DENIED ON THE INDEPENDENT BASIS THAT THESE CASES PRESENT "UNUSUAL CIRCUMSTANCES" JUSTIFYING DENIAL.

The analysis does not end once the movant has shown cause. Under section 1112(b)(1), a court can deny a motion to convert "if the court specifically finds and identifies special circumstances upon which it determines that dismissal is not in the best interests of the creditors and the estate." *15375 Memorial Corp.*, 386 B.R. at 552. The Code does not define "unusual circumstances" within the meaning of 11 U.S.C. § 1112(b). *See In re Fisher*, No. 07-61338-11,

2008 WL 1775123, at *5 (Bankr. D. Mont. Apr. 15, 2008) (citing 7 *Collier on Bankruptcy*, ¶ 1112.04[3], p. 1112-26 (15th ed. rev.)). "Unusual circumstances" has been in the Bankruptcy Code less then four years and few cases to date have addressed the term. However, it is plain from the legislative history and the several cases that have interpreted the term that unusual circumstances "contemplates conditions that are not common in most Chapter 11 cases." *Fisher,* 208 WL 1775123 at *5; *see also In re Products Int'l Co.,* 395 B.R. 101, 109 (Bankr. D. Ariz. 2008); *In re Orbit Petroleum, Inc.*, 395 B.R. 145, 148 (Bankr. D.N.M. 2008); In re *New Towne Development, LLC,* 2009 Westlaw 1110434 at *4 (Bankr. M.D. La., April 24, 2009).

In *New Towne*, the court held that there was equity in the debtor's major asset and, therefore, there was a prospect of a reorganization that would pay all claims in full. *Id.* That is an apt description of the present situation. The Debtors' major assets are the litigation claims. The evidence will show that these assets have value that will enable the Debtors to pay all creditors in full, and make their shareholders wealthy in the process. Similarly, the court in *Orbit Petroleum*, 395 B.R. at 149, held that the debtor's proposal to pay all creditors in full was a sufficient unusual circumstance to deny the section 1112(b) motion. Courts have also found unusual circumstances under a variety of facts, including where a "plan which proposes to pay all creditors in full on the effective date is an unusual circumstance sufficient to deny conversion or dismissal even in the face of demonstrated cause." *Id. at* 148.

The mere fact that creditors were not clamoring for action under section 1112(b) was held to be a basis for a finding of unusual circumstances when coupled with the court's view that such relief under section 1112(b) would serve neither them nor the debtor. Accordingly, the court denied the United States trustee's otherwise well-founded motion to dismiss the case. *In re Franmar, Inc.,* 361 B.R. 170, 180 (Bankr. D. Colo. 2006). Here, two parties in interest besides

the United States trustee have asked for conversion, but only one of them holds a claim in any amount (Novell). The other (IBM) is a creditor in by its own declaration as such; it really is a debtor of SCO's that filed a counterclaim of little or no merit. The other 180 real creditors in this case are either silent or support the Debtors in their opposition to the Motions. And, as explained, *infra*, converting these cases to Chapter 7 would not serve the creditors or shareholders, and most certainly not serve the Debtors. *See also, In re Pittsfield Weaving Co.,* 393 B.R. 271, 275 (Bankr. D. N.H. 2008)(unusual circumstances included that operating losses emanated from two unexpected, critical events, and that trade creditors were willing to "assume[ ] the risk and continue to deal with the Debtor despite accruing post-petition debt."

## III. EVEN IF THE COURT FINDS CAUSE AND INSUFFICIENT UNUSUAL CIRCUMSTANCES, CONVERSION IS NOT IN THE BEST INTERESTS OF THE ESTATES AND THEIR CREDITORS

If the Court comes to the conclusion that it must act because it finds "cause" and the lack of unusual circumstances, then it must consider what is in the best interests of creditors AND the best interests of the estate. 11 U.S.C. § 1112(b)(1). In these cases, conversion is not in the best interests of the creditors nor the estate. Either dismissal of the cases or appointment of a Chapter 11 trustee or an examiner would be far preferable, and dismissal would be the least harmful to the interests of the creditors and the estate.

"In weighing the considerations for a conversion from Chapter 11 to Chapter 7 or a case dismissal, the court should consider a totality of all the facts and circumstances based on 'the best interest of creditors and the estate' test. The court should consider, inter alia, the positions of parties in interest since their determination must be dictated by the best interests of creditors and the estate." *In re Great Am. Pyramid JV,* 144 B.R. 780, 793 (Bankr. W.D. Tenn. 1992);[116] *see*

[116] In fact, it appears that the *Great American* court surveyed the desires of the various individual creditors. *See In re Great Am. Pyramid JV,* 144 B.R. 780, 793 (Bankr. W.D. Tenn. 1992).

*also Pittsfield Weaving.*, 393 B.R. at 276 (court weighed the views of the unsecured creditors and the sole secured creditor, and dismissed case).

There are approximately 182 creditors listed in these cases, and 178 of them have not, until now, been heard from.[117] Four creditors whose claims are disputed filed proofs of claim that are the subject of objection (Novell, IBM, SuSE and Red Hat), and SCO claims that all of them are debtors of SCO on a net basis. IBM is a creditor only because it says so. In fact, as the Court knows, IBM is the defendant in a lawsuit filed by SCO and the Debtors submit it owes SCO billions of dollars. The creditors whose claims are unquestionably legitimate have not yet expressed their point of view, but the Debtors expect that, if polled, they will "vote" for dismissal instead of conversion if that decision is one that must be confronted.

Congress did not say that the Court should take the interests of only creditors into account when deciding this issue. Section 1112(b)(1) says that the test is "whichever [conversion or dismissal] is in the best interests of creditors and the estate." (Emphasis added). Therefore, interests other than those of the creditors must be considered. Here, that means the interests of the shareholders, the employees and the customers must be considered.

A Chapter 7 trustee is most unlikely to seek to continue the business of the Debtors under section 704(a)(8). Therefore, conversion of the case will almost certainly lead to the immediate shutdown of the Debtors' businesses. Immediate shutdown would have a cascade of negative repercussions for the estate.

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[117] One, the IPO class action plaintiffs, were heard from, but their claims were resolved at zero through a stipulation. *See* D.E. #615. The claim of another so-called creditor, Wayne Gray, (who took no action in the Bankruptcy Court) was resolved in federal district court litigation in Tampa and by the fact that he did not file a proof of claim as he was required to do because his claim was listed as disputed. The other three creditors who have participated are IBM, Novell, and SuSE, an affiliate of Novell, which waived its claim against SCO at a hearing on November 6, 2007.

Shutdown will mean the end for the Debtors' remaining employees, including those employed at the non-debtor foreign subsidiaries. The American employees would lose not only their pay, but also their health insurance, and COBRA probably would not be available even in the short run. Those 19 people employed by the foreign subsidiaries would also lose their jobs as payroll is sent from SCO Operations to the foreign subsidiary. Unfortunately for the estates, most foreign nations have very liberal severance laws for laid off employees that will become administrative expenses of the Chapter 7 estates. The Debtors estimate those claims to be approximately $1 million.

Conversion will also mean the end of SCO's servicing, maintenance and upgrading for its customers. SCO has a loyal customer and partner base that would be significantly and negatively be impacted by Chapter 7 liquidation of the Debtors. SCO sells its UNIX products to value added resellers who, in turn, sell them to thousands of small businesses around the world and also directly to large customers including many Fortune 1000 accounts. These customers are justifiably concerned about the negative commercial and technical impact on their business as they have come to rely upon SCO UNIX for their internal business-critical processes.

From customers having the ability to order at every one of the over 13,000 McDonald's locations throughout North America to the U.S. Navy's ability to launch F-18 fighter jets, SCO UNIX is a critical component of our economy. To literally thousands of SCO customers throughout the world running in excess of over one million servers, SCO operating platforms are an integral part of the day-to-day operations of small businesses, large replicated sites and financial or government institutions. The SCO UNIX operating system runs on hardware powered by an Intel/AMD chip set. This hardware could be HP, Dell, IBM or a generic white box solution. Each of SCO's customers uses a specific vertical application (i.e., financial,

healthcare, food services, pharmaceutical, retail, government etc.) or horizontal application that is generally certified to run on the SCO UNIX operating system. In the case of McDonald's or any other large replicated site (e.g., Walgreen, Goodyear, Costco, CSK, CVS) that uses SCO products, when an order or transaction is placed, the SCO platform works with the application to process the billions of transactions that occur on a regular basis. The importance of stability and reliability, which are the hallmarks of SCO operating system solutions, are paramount to the success of these companies. The idea for any of these companies to replace the existing SCO platform with a competing solution is extremely painful, expensive and often times a very risky proposition.

From a technical perspective, customers are unable to quickly and easily move to another operating system. They have come to rely on SCO's engineers, support and sales staff to move their business forward. Customer's applications/solutions would need to be re-engineered and re-installed, which would result in significant cost to the customers and end users, something they are very concerned about in today's economy.

The vast majority of SCO's customers have not budgeted for these incremental engineering costs and this cost would ultimately be passed on to end users and customers. Hundreds of value-added resellers have written applications to support small business in retail, manufacturing, healthcare, and other sectors. These resellers have built their business around SCO-based solutions and have also committed contracts to sell, maintain and support the small business applications running on SCO software. The disappearance of SCO would require re-negotiations and possibly liability to SCO's reseller channel due to guaranteed development and support agreements.

The SCO product line is valued in the industry as a highly reliable and secure product in which to base a company's business data and retail transactions around. It is, therefore, not surprising that there has been an outpouring of support from the Debtors' customers, asking the Court not to put the Debtors out of business. *See* Ex. 1, attached.

Finally, shareholders – many of whom invested in SCO primarily on account of SCO's claims – would justifiably fear total loss of their investments at the hands of a Chapter 7 trustee. A Chapter 7 trustee might quickly seize upon a *de minimis* settlement offered by IBM to escape from its billions of dollars of potential liability to the estates and do so before any decision of the Tenth Circuit has been rendered. The amount would pay off the claims, of course. But Chapter 7 trustees, whose fiduciary duty runs to all constituents of the bankrupt estate, including shareholders in appropriate cases, are not known for factoring shareholders' or customers' interests when considering multimillion dollar settlements.

Dismissal has none of these risks. The Debtors will be able to continue to service their customers, continue to employ their staff and the foreign subsidiaries' employees and return to paying their pre-petition debts in the ordinary course of business. SCO's fights with IBM, Novell, SuSE and Red Hat may continue in other courts, subject to the rulings of the Tenth Circuit on the matters submitted to it.

One of the primary concerns that motivated the filing of these cases has already been dissipated by the district court judgment awarding Novell around $3.5 million instead of an amount upwards of ten times that number, and more importantly, limiting the extent of the constructive trust to only about $625,000. The fear that the Debtors would be destroyed by the constructive trust is entirely gone and the Debtors have escrowed the $625,000 in the event that the constructive trust remedy is upheld on appeal. Now that the appeal has been argued in the

Novell case, and a ruling is imminent, all of the concerns about Novell have been significantly reduced. Even late last year, it was unknown how quickly the Tenth Circuit would set a briefing and argument schedule in the case.

Shareholders' hopes for a return on SCO's litigation assets would be more secure if the cases were dismissed. The decision on whether to settle would be made at arms' length and without the unnatural pressure of a bankruptcy, with its premium on expeditiousness. Therefore, the Debtors strongly prefer a dismissal if any section 1112(b) relief is to be ordered.

In *In re Kent*, 2008 WL 5047799 (Bankr. D. Ariz. 2008), one of the primary reasons why the debtors filed Chapter 11 was to resolve a dispute with a major creditor, with whom one of the debtors was in heated litigation. Once that dispute was settled, the debtors moved to dismiss the case. Upon settlement of the claim, "the amount of the claims, as measured in dollars, were reduced by 68 percent." *Id.* at *6. The court held that there was "no basis by which the creditors would benefit from a conversion of the case to one under Chapter 7 or the appointment of a Chapter 11 trustee." *Id.* at *7. Even though there remained a large disputed claim by a creditor, the fact that the creditor could pursue its claim outside of the bankruptcy court, was enough to justify dismissal over conversion. *Id.* Here, the Debtors have reduced their liabilities during the course of the cases by 91% ($97,000,000 / $106,500,000)

A similar result obtained in *In re Kholyavka*, 2008 WL 3887653 (Bankr. E.D. Pa. 2008). The court had no trouble finding cause for dismissal or conversion but opted to dismiss the case despite the United States trustee's initial desire to convert it to Chapter 7. Dismissal was the more appropriate remedy in part because of "the lack of involvement of any creditors" in the case. *Id.* at *5. That circumstance exists in these cases, as well.

In *Fisher*, the court converted the case because the debtors had lied on their schedules, transferred their property in fraud of their creditors, and made avoidable preferential transfers. The court explained its rationale in converting the case instead of opting for a different remedy thusly:

> While dismissal of this case may not provide any advantage to Debtors' creditors, conversion to Chapter 7 of the Bankruptcy Code will allow for the appointment of a Chapter 7 Trustee who can liquidated any non-exempt assets in an expeditious manner. A Chapter 7 Trustee would also, no doubt, investigate Debtors' alleged fraudulent conveyances and would pursue vigorously Debtors' preference actions. The conversion of this case to Chapter 7, as opposed to the appointment of a trustee under § 1112(b) and § 1104(a)(3), would also better serve the creditors in this case, where Debtors have no ongoing business to preserve, in that the creditors would not be burdened with the higher fees associated with the administration of a Chapter 11 case.

*Fisher*, 2008 WL 1775123 at *12 (Bankr. D. Mont. Apr. 15, 2008); *see also Orbit Petroleum,* 395 B.R. at 149 (where court denied motion to convert even though debtor's MORs showed that it was losing money, allowed debtor six additional months to get plan confirmed, then volunteered that case would be dismissed, not converted, if plan not confirmed in that time).

The court in *Original IFPC* dismissed the case rather than converting it to Chapter 7 where the debtor's primary asset was a trade-secret lawsuit. The court carefully weighed the pros and cons of the various alternatives and noted that, with the litigation so far advanced, "there appears to be no advantage to adding a Chapter 7 trustee to the process and requiring him to evaluate the debtor's claim." 317 B.R. at 754. Even more so here, with the primary lawsuit so far advanced – six years in litigation and literally weeks away from a definitive ruling on what, if the rulings are favorable to SCO, could unlock the door to perhaps billions of dollars of damages from defendants well capable of paying them – adding a Chapter 7 trustee to the calculus is not the prudent choice.

In *Pittsfield Weaving,* the debtor was losing money, was not paying its post-petition expenses and its liabilities had increased by more than $900,000. Accordingly, it found cause to dismiss or convert the case, but chose to dismiss. Among the reasons for dismissal was that the debtor's trade creditors might still want to do business with the debtor. 393 B.R. at 276. The Debtors submit that that is precisely the case here.

In *Gateway,* the court searched for ways to dismiss the case instead of converting it to Chapter 7. It suggested that "where continued operation of a debtor who provided an exclusive essential service would foster the public interest" dismissal to allow the business to continue would be the appropriate action. 374 B.R. at 568. The Debtors will introduce evidence to show that their UNIX product fits the court's description in *Gateway.* They will show that the negative effects of a discontinuance of SCO's maintenance and upgrading of its signature product would ripple through the economy and affect the public interest in an extremely negative way.

Whereas section 1112(b) is typically understood as giving the bankruptcy court the choice of either conversion of the case to Chapter 7 or dismissal of the case, BAPCPA added a third (and actually a fourth) alternative. The court can now deny relief in the form of dismissal and conversion and opt for an examiner or a Chapter 11 trustee instead.

Section 1112(b)(1) reads:

> (1) Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under Chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

11 U.S.C. 1112(b)(1) (Emphasis added).

This new clause has been interpreted as meaning that a court that finds cause but wishes not to dismiss a case or to convert it to Chapter 7 may instead appoint a Chapter 11 trustee (or examiner). *See In re Prods. Int'l Co.*, 395 B.R. 101, 108 (Bankr. D. Ariz. 2008) (citing *In re Jayo*, 2006 WL 2433451, at *6 (Bankr. D. Idaho 2006); *In re Incredible Auto Sales, LLC*, 2007 WL 1100276, at *4 (Bankr. D. Mont. Apr. 10, 2007); and 7 *Collier on Bankruptcy*, ¶ 112.04[3] (15th ed. rev.)); *see also Kent*, 2008 WL 5047799, at *5.

In *Products Int'l,* the court found cause under section 1112(b)(1). However, it denied the debtor's motion to dismiss the case because the circumstances of that case, involving a "classic owner's dispute", 395 B.R. at 106, causing the debtor to "lack[ ] a focused reorganization management team," *id.* at 111, dictated the appointment of a Chapter 11 trustee instead.

Of these two alternatives – trustee or examiner – an examiner would be the Debtors' preferred choice. The examiner's report can inform the Court, the United States trustee and creditors of an unbiased and professional opinion of the value of the Debtors' assets, including SCO's claims against Novell, IBM, AutoZone and UNIX infringers generally. Concomitant with that evaluation, of course, would be an opinion about the strength of the reciprocal claims of IBM, Novell and Red Hat. The examiner could also look into the Debtors' unsuccessful efforts at selling their assets and report on these issues as well.

A Chapter 11 trustee, who like a Chapter 7 trustee, owes fiduciary duties to the shareholders in a solvent case, has the ability to continue the business without fear of running a deficit in the Chapter 7 estate. This trustee would be able to take the time necessary to do the evaluations that an examiner would do. But the trustee option would be more expensive. First, the trustee would receive a commission based on 11 U.S.C. § 326(a) as opposed to the hourly fee or flat fee charged by an examiner. Second, notwithstanding the commission, the trustee might

opt to retain professionals who would then charge an hourly fee on top of the trustee's commission. By the time the trustee and his or her professionals have completed their evaluations, the Tenth Circuit would likely have already ruled. That fact itself would go a long way in resolving most doubts about the future of the Debtors, and render the report, be it from an examiner or a Chapter 11 trustee somewhat anticlimactic.

Accordingly, in order of preference, it is the Debtors' view that if cause is established and the Court is moved to take some action, that the Court consider either dismissing the cases or appointing an examiner, as either alternative would be far preferable to conversion of the cases to Chapter 7. And, if the Court believes that a trustee is required, then a Chapter 11 trustee, who will likely continue to operate the business for the benefit of all constituents of the estates, would clearly be the better option.

## IV. THE COURT SHOULD STAY ANY ORDER THAT WOULD GRANT ANY OF THE RELIEF REQUESTED

Better than all of the above, whatever decision the Court makes, if it perceives the need to do anything other than denying the Motions outright, the Court should stay its order for a sufficient period of time to have the benefit of the Tenth Circuit's anticipated decision. The Debtors suggest that the period be approximately 90 days from the date of the hearing, that is, September 15.

Whereas BAPCPA added an onerous and impractical deadline on the Court to act, it put no restrictions on the Court's ability to stay an order entered within the new deadline. Section 1112(b)(3) provides that, with respect to a hearing on a motion for dismissal or conversion of a Chapter 11 case, "the court shall decide the motion not later than 15 days after commencement

of such hearing." It does not say that once the Court decides the motion that it may not stay the relief that it has ordered, if appropriate cause for a stay exists.[118]

## CONCLUSION

For all of these reasons, the Debtors request that the Court deny the Motions, or grant relief consistent with the foregoing.

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[118] In fact, the section does not even say that the Court is obliged to enter an order. Technically, all it says is that the Court shall "decide" the motion. It is common practice for a court to announce a decision or write an opinion and then request the submission of an order consistent with the decision. Entry of that order could be delayed for some time depending upon circumstances and local practices. There is no deadline for the Court to enter an order consistent with its decision. Ergo, there is no impediment to a delay, or even a stay, between announcing a decision and entry of an order of dismissal or an order converting the case, or the other two alternatives (other than outright denial of the motion as discussed above).