

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

The SCO GROUP, INC., et al.,

Debtors.

Chapter 11

Case No. 07-11337 (KG)
(Jointly Administered)

Hearing Date: June 15, 2009 at 2:00 p.m.

Objection Deadline: June 11, 2009

Re: Docket No. 778

**REPLY OF INTERNATIONAL BUSINESS MACHINES CORPORATION
TO DEBTORS' RESPONSE TO MOTIONS TO CONVERT
THE DEBTORS' CHAPTER 11 CASES**

IBM,¹ a creditor and equity security holder in these Chapter 11 cases, by its undersigned counsel, submits this Reply to the Debtors' Response [Docket No. 778] to the Motions of the United States Trustee², IBM³ and Novell⁴ for an order converting (but not dismissing) the Debtors' Chapter 11 cases to cases under Chapter 7 (the "Motions to Convert").

INTRODUCTION

1. In response to the Motions to Convert, the Debtors argue (a) even though they continue to bleed cash, lose customers and shrink merely to survive and the only chance of rehabilitation is success on the appeal in their nonbankruptcy litigation (the "Utah litigation"), they should be given as long as it takes for the Utah litigation to be resolved; (b) they really are

¹ Capitalized terms used in this Reply have the meaning ascribed to them in the *Motion of International Business Machines Corporation for an Order Converting the Debtors' Chapter 11 Bankruptcy Cases to Cases Under Chapter 7 of the Bankruptcy Code* (the "IBM Motion to Convert") [Docket No. 751].

² See *Motion of the United States Trustee to Convert Cases to Cases under Chapter 7* [Docket No. 750].

³ See IBM Motion to Convert.

⁴ See *Novell's Motion for Conversion* [Docket No. 753].

not losing all that much money and besides, they have lost money every year that they have been in business; (c) their customers really need them to survive, even at the expense of all the creditors of the estate, because the creditors are not actively complaining about the losses; and (d) a Chapter 7 trustee will likely squander the opportunity to recover billions of dollars in potential damages from IBM and Novell, among others. Along the way, they ask this Court to determine that they are likely to prevail on appeal, attempting to turn the hearing on a conversion motion that this Court must decide on an expedited basis into a mini-trial of the appeal of the Utah Court's ruling. Finally, they argue that the Court should dismiss rather than convert.

2. IBM addressed each of these arguments in the IBM Motion to Convert. IBM files this Reply to connect its showing and argument in the IBM Motion to Convert to the Debtors' arguments in the Debtors' Response.

A. The Debtors Should Not Be Allowed to Remain in Chapter 11 Indefinitely Just to Pursue Litigation

3. At each stage of these Chapter 11 cases, the Debtors have argued that they need only one more step in the Utah litigation for them to rehabilitate. Their First Extension Motion filed on January 2, 2008 argued for more time to propose a plan until the Utah Court reached judgment "even if the entire judgment is on appeal". (First Extension Motion at ¶ 13.) Their Second Extension Motion filed on May 9, 2008 argued for more time to reflect the results of the May 2, 2008 trial conducted in the Utah litigation. Their Third Extension Motion filed on August 11, 2008 sought an extension until 45 days after entry of final judgment (which this Court did not grant) on the ground that entry of final judgment and commencement of an appeal would facilitate a sale or recapitalization. In arguing their Fourth Extension Motion, they stated in Court they needed only until the May 6, 2009 oral argument in the appeal.

4. Now, the Debtors argue that if only they can hold out until a favorable decision in their appeal in the Utah litigation to the United States Court of Appeals for the Tenth Circuit (the “Tenth Circuit”), they will be able to rehabilitate, customers will return, cash will be available, claims will be reduced and investors will be knocking down their door. (Debtors’ Response at 10-12.) However, they admit that a favorable ruling would result only in returning the matter to the Utah Court for trial.

5. One is left to wonder, will the Debtors then argue for further deferrals of these Chapter 11 cases, in stages, until the Utah Court tries the case, until the jury returns a verdict, until the Utah Court enters judgment, until the judgment is appealed, until there is oral argument on the appeal and until the Tenth Circuit decides? Is their present prediction that passing the next stage of litigation will make rehabilitation possible any more likely to pan out than their prior four predictions? Will the process start all over for the IBM Case, which is not nearly so advanced as the Novell Case?

B. The Debtors’ Continuing Losses Provide Cause to Convert

6. The Debtors freely admit that they are losing money and have done so continually not only since the filing of these Chapter 11 cases but for nearly all of their corporate existence. (Debtors’ Response at 5-8.) But, they argue, there has been no “substantial” diminution of the estate. To support their argument, they mis-paraphrase the statute: “the court must find (a) a substantial loss or diminution of the estate” (Debtors’ Response at 4), suggesting that the loss or the diminution must each be substantial, and then focusing on whether their losses have been substantial. (Debtors’ Response at 6.) But the statute actually provides that cause includes “substantial or continuing loss to or diminution of the estate”. 11 U.S.C. § 1112(b)(4)(A). Thus, cause is shown by substantial loss to the estate, by continuing loss to the

estate or by diminution of the estate.⁵ The Debtors admit at least the latter two grounds. There has been continuing loss, and there has been diminution of the estate. (Debtors' Response at 5-6.)

7. Continuing losses for years before a Chapter 11 case does not render "continuing loss to the estate" inapplicable as a cause for dismissal. Indeed, Chapter 11 is designed for companies that have suffered continuing losses before bankruptcy. However, section 1112(b)(4)(A) shows that Chapter 11 is designed to accommodate companies that are able to eliminate continuing losses. After 19 months, the Debtors have not been able to do so. Their Second Disclosure Statement suggested that losses would continue, even if the Second Plan of Reorganization were confirmed. (Second Disclosure Statement at 40.) The only hope the Debtors' Response now offers to reverse the trend of continuing losses is success on the Tenth Circuit appeal, a matter addressed above.

8. Section 1112(b)(4)(A) also requires the absence of a reasonable likelihood of rehabilitation to establish "cause". The Debtors' four failed Chapter 11 exit attempts show the absence of a reasonable likelihood of rehabilitation. The opportunistic arguments in the Debtors' Response do not credibly show otherwise. The Debtors' Response argues that a reversal on appeal of the Final Judgment against SCO in the Novell Case entered by the Utah Court November 20, 2008 would revitalize that business by re-attracting customers. However, the Debtors' withdrawn Second Disclosure Statement projected declining revenues for UnixWare and OpenServer products (Second Disclosure Statement at 40), without any mention that a reversal on appeal would improve those results.

⁵ "If ... the debtor is operating with a sustained negative cash flow after the commencement of the case, these facts are sufficient to justify a finding of '... continuing loss to ... the estate.'" 7 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 1112.04[5][a][i] (15th ed. rev'd 2005) (footnotes omitted).

C. The Debtors' Customers' Needs Should Not Militate Against Conversion

9. The customer letters in Exhibit 1 to the Debtors' Response are hearsay and inadmissible, and IBM intends to object to their consideration at the hearing on the Motions to Convert. (See Fed R. Ev. 802.) Even if they were admissible, however, they do not provide the unusual circumstances to establish that the requested conversion is not in the best interests of the creditors and the estate, nor do they establish a sufficient basis to support dismissal as the preferable alternative to conversion. The Debtors' argument that they should continue operations to protect their customers rather than their creditors, at the expense of what little cash remains in the estate for creditors, flies in the face of the purpose of Chapter 11. That the creditors have not objected is little surprise. As Congress recognized, creditors are often apathetic and uninvolved. That is one of the reasons Congress established the United States Trustee system, to act as a watchdog when creditors do not have sufficient interest to do so.⁶ The United States Trustee here has moved for conversion. Creditor apathy does not justify dissipating the remaining assets of the estate.

D. A Chapter 7 Trustee Would Not Squander Assets

10. Finally, the Debtors argue that this Court should dismiss rather than convert, in part because a "Chapter 7 trustee might quickly seize upon a de minimis settlement". (Debtors' Response at 47.) Leaving aside the Debtors' inappropriate impugning of the professionalism of the Chapter 7 panel trustees in this District, Bankruptcy Rule 9019 requires this Court's approval of any settlement. The Debtors, their creditors and their shareholders may all object to any settlement. Objections are not disregarded. Indeed, just last week in this

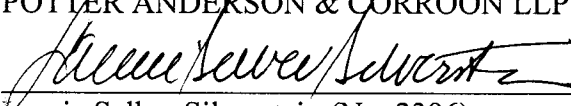
⁶ For this history generally, see 1 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 6.34[2]-[3] (15th ed. rev'd 2005).

District, the court refused to approve a major settlement over the objection of creditors. (See In re Spansion, Inc., 2009 WL 1531788 (Bankr. D.Del. June 2, 2009).) IBM believes that it does not have any liability to the Debtors or the estates and may in fact have one of the largest claims against the estates. Fear that a Chapter 7 trustee, after a dispassionate and independent review, may agree with that assessment is not a form of "unusual circumstances" to excuse conversion.

CONCLUSION

For the reasons set forth above, IBM respectfully requests that the Court grant the Motions to Convert these Chapter 11 cases to Chapter 7.

Dated: June 10, 2009

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