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IN THE UNITED STATES DISTRICT COURT

DISTRICT OF UTAH, CENTRAL DIVISION

THE SCO GROUP, INC., a Delaware
corporation,

Plaintiff,

vs.

NOVELL, INC., a Delaware corporation,

Defendant.

AND RELATED COUNTERCLAIMS.

Case No. 2:04CV00139

**MEMORANDUM IN SUPPORT OF
NOVELL, INC.'S *DAUBERT*
MOTION TO DISQUALIFY
DR. CHRISTINE A. BOTOSAN**

Judge Ted Stewart

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Dr. Christine A. Botosan has two basic opinions: SCO lost at least \$137 million in profits, and Novell caused that loss. As explained below, neither is admissible.

I. INTRODUCTION AND SUMMARY OF ARGUMENT

In January 2003, SCO launched SCOsource, “an effort to obtain license fees from Linux users based on SCO’s claims to UNIX intellectual property allegedly contained in Linux.” (Dkt. 542 at 13.) SCO then reported in publicly-available Forms 10-Q filed with the SEC (reproduced as Exs. B & C hereto) that “[d]ue to a lack of historical experience and the uncertainties related to SCOsource licensing revenue,” it was “unable to estimate the amount and timing of future [SCOsource] licensing revenue, if any”; and “SCOsource licensing revenue is unlikely to produce stable, predictable revenue for the foreseeable future.” (Ex. B at 33; Ex. C at 33.)

In contrast to what SCO said then, its expert now says SCOsource would have generated at least \$137 million in profits, but for the fact that Novell questioned whether SCO owns the rights it was trying to license. To arrive at lost profits, Dr. Botosan first calculates lost *revenues*, by subtracting SCO’s actual licensing revenues from what they were projected to be. She then deducts what she estimates SCO’s costs would have been to generate those revenues, in order to arrive at lost *profits*. Two basic flaws infect this part of her analysis, both going to her starting point. First, she cherry-picked the highest projections she could find. Second, instead of performing any meaningful analysis of those cherry-picked projections, such as applying discounts based on the recognized risk factors, she just parrots them.

Dr. Botosan’s causation analysis is even more deeply flawed. First, she bases her opinion on an event study purporting to show that Novell caused SCO’s stock price to drop, but the Court has already ruled “that decline in stock price is not an appropriate claim for special damages.” (Dkt. 621 at 12.) Second, her event study is invalid, as is her reasoning therefrom. Finally, she cannot bridge the gap between the conclusion she draws from her event study—viz., that Novell caused SCO’s stock price to drop—and her opinion that Novell caused SCO to lose sales.

II. LEGAL PRINCIPLES

If ... specialized knowledge will assist the trier of fact ... a witness ... may testify thereto in the form of an opinion ... if ... the testimony is based upon sufficient facts or data ... [and] is the product of reliable principles or methods ... applied ... reliably to the facts of the case.

Fed. R. Evid. (“Rule”) 702. Under this Rule, “expert testimony must be both reliable and relevant.” *Hynes v. Energy West, Inc.*, 211 F.3d 1193, 1203 (10th Cir. 2000) (citing *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589-92, 113 S. Ct. 2786 (1993)). Regarding reliability, “[u]nder *Daubert*, any step that renders the analysis unreliable renders the expert’s testimony inadmissible. This is true whether the step completely changes a reliable methodology or merely misapplies the method.” *Mitchell v. Gencorp, Inc.*, 165 F.3d 778, 782 (10th Cir. 1999) (citation omitted). As for relevance, “the court must ensure that the proposed expert testimony logically advances a material aspect of this case,” i.e., has “a valid scientific connection to the disputed facts in the case.” *Norris v. Baxter Healthcare Corp.*, 397 F.3d 878, 884 n. 2 (10th Cir. 2005).

III. ARGUMENT

A. Dr. Botosan’s Opinion as to the Amount of Lost Profits Is Inadmissible

Dr. Botosan calculates SCO’s alleged damages in three steps. She first identifies *projected revenues*. (Report & Decl. of Christine A. Botosan [“Report,” reproduced as Ex. A hereto] at ¶¶ 41-48.) Then she calculates *lost revenues* by subtracting *actual* from *projected* revenues. (*Id.*) Finally, to derive *lost profits*, she deducts from lost revenues what she estimates SCO’s additional costs would have been, had it generated those revenues. (*Id.* at ¶¶ 49-59.) The differences calculated in steps two and three can be no more reliable than the projections from which Dr. Botosan starts, and as explained below, “fundamental flaw[s]” in her identification of projected revenues “cause[] the overall ... opinion to be the Rule 702 equivalent of what in early computer vocabulary bore the label ‘GIGO’ (‘garbage in, garbage out’).” See *Kay v. First Cont’l Trading, Inc.*, 976 F. Supp. 772, 776 (N.D. Ill. 1997).

1. Cherry-Picking the Highest Projections Is Not a Reliable Method

No defensible methodology supports the projected revenues figure from which Dr. Botosan derives lost profits. Dr. Botosan draws her projections from three sales forecasts: one by Renaissance Research Group (“RRG”) on March 6, 2003; another by SCO itself on June 26, 2003; and a third by Deutsche Bank (reproduced as Ex. E hereto) on October 14, 2003. (Report at ¶¶ 32, 37, 38.) In her Report, she discounts two other forecasts—one by RRG on February 24, 2003, and the other by SCO on August 11, 2004—which projected much lower revenues; and she entirely ignores still other (less favorable) forecasts.¹ (*Id.* at ¶¶ 32, 39.) Instead of trying to reconcile the forecasts she does use, she adopts the highest figure from among them:

- For 2003, Dr. Botosan adopts the SCO forecast, the only one of the three to project revenues higher than those actually achieved. (*Id.* at ¶¶ 35, 42.)
- For 2004, Dr. Botosan adopts Deutsche Bank’s \$53 million projection (rather than SCO’s \$40 million² or RRG’s \$15 million projection). (*Id.* at ¶ 43 & Exs. 4, 5.)
- For 2005, Dr. Botosan adopts Deutsche Bank’s \$52 million projection (SCO made no projection; RRG projected \$10 million). (*Id.* at ¶ 44 & Exs. 4, 5.)
- To maximize projected revenues for 2006, Dr. Botosan *combines* figures cherry-picked from the various forecasts, adding together \$42 million for end user licensing (carried over from Deutsche Bank’s 2005 forecast) to \$10 million projected by RRG for 2006. (*Id.* at ¶ 45.)

¹ E.g., Dr. Botosan never mentions a Decatur Jones forecast (Ex. D hereto), issued just two months before Deutsche Bank’s, which rated SCO stock to “underperform” and forecast much lower revenues. The Deutsche Bank forecast also is based on faulty information. To support its inflated projections, Deutsche Bank relies heavily on two separate licensing agreements, one for which Microsoft paid SCO \$16 million and another for which Sun paid SCO \$10 million. (*See* Ex. E at 18.) However, SCO’s former CEO testified during the bench trial in this matter that those agreements were not SCOSource licenses: “Q. Were the Sun and Microsoft licenses SCOSource licenses or not? A. No. They were UnixWare licenses.” (Ex. F at 246:13-15.)

² According to Dr. Botosan, the SCO forecast was made before SCO began separately targeting both Linux vendors and end users, and thus projects only the revenue component projected by Deutsche Bank as \$30 million. But that gloss ignores the fact that there is a tradeoff between vendor and end user licensing (because the end user of Linux acquired from a licensed vendor is protected by the vendor’s license). The bottom line is that SCO projected it could extract \$13 million less from the market than Deutsche Bank did, by whatever means. (Report Ex. 5.)

- For 2007, Dr. Botosan carries over the figures from 2006. (*Id.* at ¶ 46.)

Finding the most generous forecasts available, and then selecting the highest projections from within those, is not a reliable principle or method. *See* Rule 702; *Norris*, 397 F.3d at 886 (rejecting testimony of experts who ignored contrary studies).

2. Dr. Botosan Is a Mere Conduit for Opinion Hearsay

Rule 702 requires expert testimony to be “based upon sufficient facts or data.” In this context, “‘data’ is intended to encompass the reliable opinions of other experts.” Advisory Comm. Notes to 2000 Ams. But expert testimony *based upon* the opinions of other experts is not the same as testimony that simply repeats the untested opinions of others. While the former may be admissible expert testimony, the latter is inadmissible hearsay; and Dr. Botosan’s testimony regarding projections falls into the latter category.

The Tenth Circuit applied this distinction in *Hensel Phelps Constr. Co. v. United States*, 413 F.2d 701 (10th Cir. 1969), to distinguish *6816.5 Acres of Land v. United States*, 411 F.2d 834 (10th Cir. 1969). In *6816.5 Acres*, the court responded to the appellant’s contention “that the testimony of the Government’s mineral valuation expert ... was based on his opinion of a colleague’s opinion” with the admonition: “the trial court must take steps to exclude any expert opinion that is predicated upon another opinion.” 411 F.2d at 839-40. Then, in *Hensel*, the court explained that *6816.5 Acres* “is not controlling here because Henley used the independent estimates” of other experts “to corroborate the figure which he, Henley, had reached through his own analysis.” 413 F.2d at 704. Other cases from other Circuits are to the same effect. In *United States v. Tomasian*, 784 F.2d 782, 783, 786 (7th Cir. 1986), to ascertain the value of “a pair of large elephant tusks” stolen from “a private club in Tucson,” “Stone consulted outside sources to ascertain the price per pound of ivory and then multiplied that figure by the weight of the tusks.” The Seventh Circuit affirmed the trial court’s exclusion of Stone’s testimony, explaining: “Stone could only relay another’s opinion of the price per pound of ivory. He had

no opinion of his own on that matter Rule 703 does not sanction the simple transmission of hearsay; it only permits an expert opinion based on hearsay.” *Id.* at 786.

So too, here, Dr. Botosan is simply relaying the (highest) revenue projections she could find, modified only by calculations no more meaningful than Stone’s multiplication of price per pound by the weight of an elephant’s tusk. *See also Hutchinson v. Groskin*, 927 F.2d 722, 725 (2d Cir. 1991) (“By asking Dr. Bronson to identify the documents ... and then state whether his opinion was consistent with those expressed in the documents, defense counsel used Dr. Bronson as a conduit for hearsay testimony. Defense counsel thereby introduced the purported opinions of Doctors ... whom plaintiff had no opportunity to examine.”)

B. Dr. Botosan’s Proposed Testimony on Causation Is Inadmissible

According to Dr. Botosan, “Novell’s actions ... were a substantial factor in undermining SCO’s ability to sell its SCOSource products.” (Report at ¶ 18.) That opinion has four supports:

1. “depositions of SCO personnel ... revealed that customers were deterred from purchasing SCOSource licenses by Novell’s actions” (*id.* at ¶ 18);
2. a letter from Merrill Lynch “citing the ‘legal and factual uncertainty surrounding [SCO’s] assertions regarding intellectual property ownership and infringement’” (*id.* at ¶ 19 [bracketing in original]);
3. “SCO’s RTU program did not meet with the customer acceptance that was projected” (*id.* at ¶ 20); and
4. “an independent event study to evaluate the market’s reaction to Novell’s May 28, 2003 open letter asserting ownership” (*id.* at ¶¶ 21-27).

As shown below, *none* of the foregoing is a proper basis for Botosan’s proposed testimony.

First, if “SCO personnel” have percipient knowledge, *they* can testify to it (either live or through deposition). An expert is not needed to parrot what percipient witnesses could say for themselves—unless it is to sidestep the hearsay rules that would otherwise bar admission, which is *not* a permissible use of an expert. *See United States v. Stone*, 222 F.R.D. 334, 341 (E.D. Tenn. 2004) (“the trial court ... must ensure that the expert witness is truly testifying as an expert

and not merely serving as a conduit through which hearsay is brought before the jury”). Second, the Merrill Lynch letter cites uncertainty about both ownership *and* infringement, and a letter identifying *two* sources of uncertainty cannot support the inference that *one* was the cause of Merrill Lynch’s decision not to take a license. Third, to reason that because SCO’s licensing program fell short of projections and that Novell must have caused SCO’s licensing program to fall short of projections, is merely to assume what Dr. Botosan supposedly set out to prove. So Dr. Botosan’s opinion stands or—as shown below—falls with her event study.

1. Dr. Botosan’s Event Study Is Irrelevant

An event study examines the association between newly disclosed information about a company and its stock price movements. Where the price movements are unexplained by factors affecting the market as a whole, and are statistically significant, a “causal connection” is established between the event considered and the price movements.

(Report at ¶¶ 21, 22.) But the Court has already ruled “that decline in stock price is not an appropriate claim for special damages” (Dkt. 621 at 12) and “[e]xpert testimony which does not relate to any issue in the case is not relevant and, ergo, non-helpful,” *Daubert*, 509 U.S. at 591 (quoting 3 J. Weinstein & M. Berger, *Weinstein’s Evidence* ¶ 702[02], p. 702-18 (1988)); *see also United States v. Davis*, 40 F.3d 1069, 1075 fn. 6 (10th Cir. 1994) (“improperly applied science cannot assist the trier of fact”). Because this is a lost profits case, and Dr. Botosan’s event study—even if valid—could only explain why the stock price declined, it is irrelevant.

2. Dr. Botosan’s Event Study Is Based on a Statistically Invalid Model and a Statistically Insignificant Regression

“[C]orrelation does not equal causation.” *Norris*, 397 F.3d at 885. A *successful* event study can support an inference that there is a causal connection between correlated events by eliminating alternative explanations. *See In re Enron Corp. Sec. Derivative & ERISA Litig.*, 529 F. Supp. 2d 644, 720 (S.D. Tex. 2006). In the present case, Dr. Botosan claims her event study proves that Novell’s May 28 announcement caused SCO’s stock price to drop by showing that

the movement in SCO's stock price was out of step with the broader market. But as shown below, her event study is unsound because the underlying regression is statistically insignificant.

As Dr. Botosan explains in Appendix 1 to her Report (separately reproduced as Ex. G hereto), the essential starting point for her study is a market model developed by conducting a regression analysis to ascertain how the performance of SCO's stock performs relates to the broader market. Once that relationship is established, the broader market is used as a baseline against which to measure SCO's stock and thereby identify abnormalities; i.e., movements in SCO's stock price that vary to a statistically significant degree from the relationship with the broader market established by the regression analysis. When an otherwise unexplained abnormality correlates with an event, Dr. Botosan infers that the event caused the abnormality because broader market forces have been ruled out by the underlying regression analysis.

To assess the statistical validity of such models and analyses, courts have considered the coefficient of determination, denoted R^2 (or R2); the t-statistic; and the probability (or P) value. *See Griffin v. Board of Regents of Regency Univ.*, 795 F.2d 1281, 1290-91 & nn. 18-20 (7th Cir. 1986).³ The R2 value of the underlying regression analysis measures the explanatory power of the market model around which Dr. Botosan's event study is built, which "[o]bviously ... is a factor that may legitimately be considered ... in deciding whether the model may be relied upon." *Griffin*, 795 F.2d at 1291 n. 20, 1292. The explanatory power of the model considered by *Griffin* (R2=0.45) was more than one hundred times greater than Dr. Botosan's (R2=0.003), yet *Griffin* upheld the trial court's determination that inferences could not reliably be drawn from it. *Id.* at 1291. Here, the R2 value indicates that broader market forces explain movements in

³ To estimate the costs she subtracts from lost revenues to calculate last profits in the last step of her damages calculation, Dr. Botosan performed three other regression analyses, and carefully documented the R2 and P-values for each. (*See* Report, Exs. 9-11.) Dr. Botosan did not provide that information for the analysis on which her event study is based, so Novell had someone else calculate them: the R2 value is 0.003964 (adjusted, 0.002639) and the P-value is 0.084062. (Decl. of Terry L. Musika, attached hereto as Ex. H.)

SCO's stock price *less than one half of one percent* of the time. See *Griffin*, 795 F.2d at 1291 n.

20. The virtually unchecked volatility of SCO's stock price relative to the market as a whole means there is no valid baseline against which SCO's stock can be measured to identify abnormal returns, and thus *no* meaningful event study can be done with SCO's stock price.

The P-value (and the t-statistic), in turn, measures the statistical significance of the underlying regression. *Griffin*, 795 F.2d at 1290 n. 18, 1291 n. 19. "[T]o be statistically significant" the regression should have "[a] P-value *below* .05." *Griffin*, 795 F.2d at 1291 n. 19 (emphasis added). Dr. Botosan's P-value (0.084062) is nearly twice that.

3. Dr. Botosan's Reasoning from her Event Study Is Logically Invalid

The process by which Dr. Botosan reasons from her event study is as invalid logically as the study is statistically. That study can be summarized in the following conditional syllogism⁴:

1. If "newly disclosed information about a company" coincides with "stock price movements," and "the price movements are unexplained by factors affecting the market as a whole, and are statistically significant," then "a 'causal connection' is established between the [information] and the price movements." (Report at ¶ 22.)
2. Novell's May 28, 2003 announcement regarding copyright ownership coincided with a statistically significant drop in the price of SCO stock, and that drop is unexplained by factors affecting the market as a whole. (*Id.* at ¶ 23.)
3. Therefore, Novell's May 28, 2003 announcement caused SCO's stock price to drop. (*Id.*)

No. 1 states the principle on which event studies are based. No. 2 states facts allegedly supported by the empirical data. No. 3 is the conclusion inferred from the nos. 1 and 2. Building on that conclusion, Dr. Botosan continues:

⁴ See *LASERS v. McWilliams*, 996 So. 2d 1036, 1049 (La. 2008) (Calogero, C.J., dissenting) ("most legal arguments and conclusions are based on ... a conditional syllogism," which "begins with a major premise ... stated as an if-then proposition"; continues with "a minor premise that ... applies the ... principle stated in the major premise to the specific facts of the case"; and ends with "the conclusion").

4. “If market participants had expected Novell’s announcement to diminish SCO’s expected future cash flows, firm value would have declined in response to Novell’s statement.” (Report at ¶ 23.)
5. “In fact, firm value did decline in response to Novell’s statement.” (*Id.*)
6. Therefore, market participants expected Novell’s announcement to diminish SCO’s cash flows.

Novell assumes *arguendo* that no. 4 has some justification, and no. 5 just restates the conclusion from the event study. But drawing the conclusion stated in no. 6 from those premises “is like saying, ‘Pneumonia makes you cough; therefore, if you cough, you have pneumonia.’” *Paulson v. Texas*, 28 S.W.3d 570, 572 (Tex. Crim. App. 2000). “This form of argument is referred to in basic logic textbooks as the ‘Fallacy of Affirming the Consequent’ and is universally condemned as invalid.” *Pirtle v. Cook*, 956 S.W.2d 235, 248 (Mo. 1997) (Price, J., dissenting) (citing Irving M. Copi, *Introduction to Logic*, p. 292 (5th ed.)).⁵ An opinion arrived at by a “form of argument ... universally condemned as invalid” is inadmissible. *See Mitchell*, 165 F.3d at 782 (“any step that renders the analysis unreliable renders the expert’s testimony inadmissible”)

4. Dr. Botosan’s Opinion Is Based on Insufficient Data

Dr. Botosan’s invalid argument from her invalid event study still does not get to her conclusion that Novell caused SCO to miss Deutsche Bank’s revenue projections. To get there, Dr. Botosan must make still further unwarranted and unsupportable leaps of logic, which she does not even *attempt* to justify. Specifically, to reach her conclusion Dr. Botosan must infer, from the “fact” that market participants *expected* Novell’s announcement to diminish SCO’s cash flows the conclusion, that the announcement *did* diminish SCO’s cash flows; and indeed that *all* discrepancies between projected and actual revenues were caused by Novell. Manifestly, that

⁵ *See also Gilliam v. Nevada Power Co.*, 488 F.3d 1189, 1196 n. 7 (9th Cir. 2007) (rejecting “Gilliam’s argument” because it “rests on the logical fallacy of affirming the consequent”); *Green Ridge v. Kreisel*, 25 S.W.3d 559, 563 n. 2 (Mo. Ct. App. 2000) (“The fallacy is often expressed as ‘If p, then q; q; therefore p.’ The statement is not true because there may be things other than p that also occur with q.”).

some stock traders *thought* Novell's announcement would have a negative effect on sales is insufficient data from which to infer that it *did*; and even if there were some basis from which to infer that Novell caused SCO to lose *some* sales, there is *no* basis, whatsoever, for Dr. Botosan's conclusion that Novell proximately caused SCO to lose each and every sale Deutsche Bank incorrectly predicted SCO would make.

[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert. A court may [and this Court *should*] conclude that there is simply too great an analytical gap between the data and the opinion proffered."

General Electric Co. v. Joiner, 522 U.S. 136, 146, 118 S. Ct. 512 (1997).

In addition to being unfounded, Dr. Botosan's theory also is belied by more nearly contemporaneous evidence, such as the very Deutsche Bank projection that she adopts as her damages base. That projection was made five months *after* Novell's May 28 letter. Apparently Deutsche Bank did not think Novell's announcement would prevent SCO from reaching its targets. Moreover, between Novell's May 28 letter and Deutsche Bank's October 14 forecast, SCO's stock price rose from \$6.60 to \$15.53; and on October 15, closed at \$20.50.⁶ If stock price is a measure of investor optimism about SCOSource license sales, that optimism rose to fever pitch in the months *following* Novell's letter. It is hard to conceive a more conclusive demonstration of the unreliability of the prognostications by investors whose imputed predictions Dr. Botosan wants to tell the jury must have been right.

IV. CONCLUSION

Because Dr. Botosan's opinions are predicated on unsound and indefensible methodology, they are inadmissible and she should be precluded from testifying.

⁶ Daily historical information is available from several sources, including yahoo.com. The overall trend is graphically illustrated in the chart reproduced as Ex. I hereto, from the July 30, 2007 rebuttal report by Novell's expert.

DATED: February 8, 2010

Respectfully submitted,

By: /s/ Sterling A. Brennan
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