

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

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

Hearing Date: 1/27/2010 at 3:00 p.m. (ET)
Objection Deadline: 1/20/2010 at 4:00 p.m. (ET)

**MOTION OF THE CHAPTER 11 TRUSTEE FOR ENTRY OF AN ORDER (1)
CONFIRMING THAT CERTAIN STOCK OPTIONS GRANTED POST-PETITION
WERE AWARDED IN THE ORDINARY COURSE OF THE DEBTORS' BUSINESS (2)
AUTHORIZING THE TRUSTEE TO HONOR CERTAIN STOCK OPTIONS
EXERCISED IN ACCORDANCE WITH THE DEBTORS' BOOKS AND RECORDS
(3) CONFIRMING NOTICE AS GIVEN IS SUFFICIENT AND
(4) GRANTING RELATED RELIEF**

Edward N. Cahn, Esq. (the "Chapter 11 Trustee" or "Trustee"), in his capacity as Chapter 11 Trustee for the SCO Group, Inc. ("SCO") and SCO Operations, Inc. ("Operations") (SCO and Operations collectively, the "Debtors") seeks an order (1) confirming that certain stock options granted to the Debtors' board of directors post-petition were awarded in the ordinary course of business, (2) authorizing the Trustee to honor any post-petition stock options properly exercised by the board members according to the Debtors' books and records, (3) confirming notice of this motion, as given, is sufficient, and (4) granting such other relief as is just and proper (the "Motion"). In support of the Motion, the Trustee respectfully state as follows:

Jurisdiction

1. This Court has jurisdiction over these cases under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding per 28 U.S.C. § 157(b)(2).

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.

Background

A. General Background

2. On September 14, 2007 (the “Petition Date”), the Debtors filed voluntary petitions in this Court for relief under chapter 11 of the Bankruptcy Code. The Debtors’ chapter 11 cases are being jointly administered. No official committee of unsecured creditors has been appointed.

3. On August 25, 2009 (the “Trustee Appointment Date”), this Court approved the appointment of Edward N. Cahn, Esq. as the Chapter 11 Trustee in these cases [Dkt No. 900]. From the Petition Date to the Trustee Appointment Date the debtors operated as debtors in possession. Since the Trustee Appointment Date, the Trustee has continued to operate the companies in the chapter 11.

4. The Debtors are publicly held Delaware corporations with their corporate headquarters located in Lindon, Utah. The Debtors’ core business focus has been to serve the needs of small-to-medium sized businesses and branch offices and franchisees of Fortune 1000 companies, by providing reliable, cost-effective UNIX software technology for distributed, embedded, and network-based systems.

B. Pre-Petition Stock Option Plans

5. Since 1998, SCO has established stock option plans designed to promote the interests of SCO and its stockholders by incentivizing and rewarding employees who make a long-term contribution to the success of the company.

6. During the fiscal year ended October 31, 1998, SCO implemented the *1998 Stock Option Plan* (the “1998 Plan”) that provided for the granting of non-qualified stock options to purchase shares of common stock. On December 1, 1999, SCO’s board of directors approved the *1999 Omnibus Stock Incentive Plan* (the “1999 Plan”), which was intended to serve

as the successor equity incentive program to the 1998 Plan. The 1999 Plan allowed for the grant of awards in the form of incentive and non-qualified stock options, stock appreciation rights, restricted shares, phantom stock and stock bonuses. Awards were granted to individuals in the Debtors' employ or service.

7. On May 16, 2003, SCO's stockholders approved the *2002 Omnibus Stock Incentive Plan* (the "2002 Plan") upon the recommendation of the board of directors. The 2002 Plan also permitted the award of stock options, stock appreciation rights, restricted stock, phantom stock rights, and stock bonuses.

8. On April 20, 2004, SCO's stockholders approved the *2004 Omnibus Stock Incentive Plan* (the "2004 Plan") upon the recommendation of the board of directors. A copy of the 2004 Plan is attached hereto as Exhibit A. There have not been any plans adopted since the 2004 Plan.² The compensation committee of SCO's board of directors (the "Compensation Committee") administered the 2004 Plan. The Compensation Committee had the discretion to determine the terms of the options, the exercise price, the number of shares subject to each option, and the exercisability of the options. The Compensation Committee's practice was to grant stock options with an exercise price equal to fair market value of the common stock on the date of the grant, except that the exercise price of incentive stock options must be equal to or greater than the fair market value of the common stock as of the date of the grant.

9. Under the terms of the 1999, 2002 and 2004 Plans, SCO's board of directors may suspend, revise, terminate or amend any of the option plans at any time; provided, however, that stockholder approval must be obtained if and to the extent that the board deems it appropriate to satisfy Section 162(m) of the Internal Revenue Code, Section 422 of the Internal

² Under the terms of the Plans options generally expire 10 years from the date of grant or within 90 days of termination of employment (or 120 days for non-qualified stock options).

Revenue Code or the rules of any stock exchange on which the common stock is listed. No action under the option plans may, without the consent of the participant, reduce the participant's rights under any outstanding incentive award.³

10. There are various components to the 2004 Plan. One component of the 2004 Plan is the award of Options.⁴ An Option is defined as "an option to purchase shares of Common Stock granted pursuant to Section 7 of the [Stock] Plan." 2004 Plan, § 2(s).

11. Pursuant to the 2004 Plan, the exercise price of an Option is set by the committee administering the 2004 Plan in its discretion on a case by case basis, but in the case of an Incentive Stock Option, shall not be less than the Fair Market Value of the Common Stock on the date of the grant. 2004 Plan, § 7(b).

C. Post-Petition Grants of Stock Options to the Debtors' Board of Directors

12. The Trustee is advised that prior to the chapter 11 filing, the board of directors each received between \$8,750 and \$11,250 per quarter as compensation for serving on the board. By resolution dated September 13, 2007, the board of directors approved the award of 10,000 Options to each director on a quarterly basis as compensation for serving on the board, in lieu of cash. The quarterly grants were awarded pursuant to the 2004 Plan. The grants were awarded after the close of each quarter, up and until the second quarter of 2009. Due to an apparent oversight, the Debtors failed to timely grant Options to the board members for the second and third quarters of 2009, and therefore, by board resolution dated August 3, 2009, the board of directors were awarded the pre-approved Options as compensation for the second and third quarters of 2009.

³ The 1998 Plan provides that the board has exclusive authority to amend or modify the plan in any respect; however, no amendment or modification shall adversely affect the rights and obligations of options issued unless the optionee consents to such amendment or modification.

⁴ Capitalized terms not otherwise defined have the meanings ascribed in the 2004 Plan.

13. Additionally, pursuant to the 2004 Plan, the directors were also annually awarded 15,000 Options for each year they served on the board. The directors were awarded post-petition Options on the dates and in the amounts and at the exercise price as set forth on Exhibit B hereto. In total, the directors were awarded 660,000 Options post-petition. As of the date of this Motion, there are approximately 21,586,000 shares outstanding, thus the directors' options account for approximately 3% of the total outstanding shares.

14. The Debtors treated the post-petition award of Options to the directors as transactions in the ordinary course of business.

15. During the month of December, the directors exercised the Options granted to them, because they were concerned that as a result of the appointment of the Trustee, their the options would expire within 120 days after the Trustee Appointment Date, pursuant to section 7(e) of the 2004 Plan which provides that non-qualified stock options must be exercised with 120 days of an employee's termination.⁵ See 2004 Plan § 7(e). While the exercise appears to be in the ordinary course of business, out of an abundance of caution, the Trustee is holding in escrow all funds paid by the directors to exercise the Options until the Trustee receives authorization from the Court to honor these Option exercises.⁶

⁵ While the Trustee does not take a position on this issue, it is conceivable that the directors' options did not expire within 120 days after the Trustee was appointed and continue to remain exercisable. Pursuant to, section 7(f) of the 2004 Plan, "[u]pon a change in control... Options granted...shall remain exercisable until their expiration notwithstanding the provisions of Section 7(e) the [2004] Plan." It is possible that the appointment of the Trustee triggered such a "change in control", thereby continuing the exercise right until the expiration of the options. See *Oil and Grease on Wheels, Inc. v. Medicare Supply Co. of New England*, 2000 R.I. Super. LEXIS 32 (R.I. Super. April 26, 2000) (holding that, in an analogous situation, appointment of a receiver by a state court to handle a company's liquidation constituted a "change in control").

⁶ The shares to be issued to the directors pursuant to the exercise are restricted securities for purposes of the state and federal securities laws. As such, these securities are subject to restrictions on transfer which limits the ability of the holder to freely resell such securities.

Relief Requested

16. The Trustee seeks the entry of an order (i) confirming that the post-petition Options granted to the directors, pursuant to the 2004 Plan, were awarded in the ordinary course of the Debtors' business, (ii) authorizing the Trustee to honor any post-petition Options properly exercised by the directors based on the exercise price and expiration date in accordance with the Debtors' books and records, and (iii) confirming that notice of this Motion, as given, is sufficient.

Basis for Relief Requested

17. The Bankruptcy Code provides, in relevant part:

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

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

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

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

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

“The test for the horizontal dimension ‘is whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry.’” *Id.* (quoting *Roth American*, 975 F.2d at 953). The vertical dimension “analyzes the transactions from the vantage point of a hypothetical creditor and the inquiry is whether the transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided to extend credit.” *Id.* (quoting *Roth American*, 975 F.2d at 953). Pursuant to the vertical test, “a debtor’s pre-petition business practices and conduct is the primary focus of the vertical analysis.” *Id.* “The Court must ‘also consider the changing circumstances inherent in the hypothetical creditor’s expectations.’” *Id.*

21. The Trustee submits that the horizontal and vertical dimensions are met with respect to the post-petition grants of Options to the Debtors’ directors. The award of the Options is a common practice in the Debtors’ industry. With respect to the so-called “vertical test”, the evidence will show that SCO had the 2004 Plan, and others like it since at least fiscal year 1998, a fact that is well-known through the filings required of public companies. Therefore, hypothetical creditors would be well aware of the “risk” inherent in the Debtors’ stock option plans. The Trustee further submits that the award of Options post-petition did not harm or have any negative impact on creditors since an option simply allows the board members to purchase shares of SCO and does not deplete the estate’s cash or diminish the value of its other assets in any fashion. Accordingly, the Trustee submits that the Options granted to the Debtors’ board of directors post-petition were awarded in the ordinary course of business.

22. The Trustee further submits that honoring any properly exercised Options is an ordinary course of business transaction. It is implicit that, if the grant of stock options is a common industry practice, honoring the exercise of those options must also be a common

industry practice. Further, the exercise of the Options will not harm or have any negative impact on creditors. Instead, exercise of the Options will provide value to the Debtors' estates because the Options will be exercised at fair market value and the Debtors will receive cash payments for the exercise of the Options.

23. The Trustee recognizes that the grant and exercise of Options may have a dilutive effect on the current SCO stockholders' value and voting rights, however the dilutive effect on the current stockholders is believed to be de minimis. Additionally, the stockholders approved the 2004 Plan which explicitly authorizes the issuance of Options without further notice to the stockholders. Therefore, the Trustee submits that the relief requested herein is appropriate because it is in the best interest of the creditors and the Debtors' estates and has only a de minimis impact on the current SCO stockholders. The Trustee further submits that, in light of the de minimis impact on the stockholders and the fact that the stockholders previously approved the 2004 Plan, further notice to the stockholders is not necessary.

24. The relief requested herein is not intended to be and shall not be construed as an assumption by the Trustee of any of the Debtors' pre-petition stock option plans or stock option agreements. Accordingly, the Trustee reserves the right to reject any such plans or agreements in the future.

Notice

25. Notice of this Motion has been or will be given to the following parties or, in lieu thereof, to their counsel, if known: (i) the Office of the United States Trustee; (ii) the creditors holding the 20 largest unsecured claims against the Debtors' estates (on a consolidated basis); (iii) all board members listed on Exhibit B attached hereto; and (iv) any party which has filed a request for notices with this Court prior to the date of this Motion. The Trustee submits that further notice to stockholders is not necessary in light of the de minimis impact on the

stockholders and the fact that the stockholders previously approved the 2004 Plan which explicitly authorizes the issuance of Options without further notice to the stockholders.

WHEREFORE, the Trustee respectfully requests entry of an order substantially in the form attached hereto granting the relief requested herein and such other and further relief as is just and proper.

Dated: January 8, 2010

Respectfully submitted,

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