

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re

Chapter 11

THE SCO GROUP, INC., *et al.*,

Debtors.

Case Number 07-11337 (KG)
(Jointly Administered)

**OBJECTION OF THE UNITED STATES TRUSTEE TO THE EMERGENCY MOTION
OF THE DEBTORS FOR AN ORDER (A) APPROVING ASSET PURCHASE
AGREEMENT, (B) ESTABLISHING SALE AND BIDDING PROCEDURES, AND (C)
APPROVING THE FORM AND MANNER OF NOTICE OF SALE
(DOCKET ENTRY # 149)**

In support of her objection to the emergency motion of the Debtors for an order (a) approving the asset purchase agreement, (b) establishing sale and bidding procedures, and (c) approving the form and manner of notice of the sale (the “Motion”), Kelly Beaudin Stapleton, United States Trustee for Region 3 (“U.S. Trustee”), by and through her counsel, avers:

INTRODUCTION

1. Under (i) (an) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a) and (ii) 28 U.S.C. § 157(b)(2)(A), this Court has jurisdiction to hear and determine the Motion.
2. Under 28 U.S.C. § 586, the U.S. Trustee has an overarching responsibility to enforce the laws as written by Congress and interpreted by the courts. See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that U.S. Trustee has “public interest standing” under 11 U.S.C. § 307 which goes beyond mere pecuniary interest); Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th

Cir. 1990) (describing the U.S. Trustee as a “watchdog”).

3. Under 11 U.S.C. § 307, the U.S. Trustee has standing to be heard on the Motion and the issues raised in this objection.

GROUNDS/BASES FOR RELIEF

4. The U.S. Trustee objects to the Motion on the grounds identified below.

No Discussion of Marketing Process to Date

5. In the Motion, the Debtors do not provide any details regarding their efforts to market their assets for sale prior to executing the Term Sheet with Proposed Purchaser. While such details are relevant to determining whether the Debtors conducted the sale process in good faith (an issue that will be addressed at a later hearing in the event bidding procedures are approved), they are also relevant to evaluating whether this Court should endorse the Debtors’ suggested timetable for the auction and sale. The Debtors should make a record regarding their pre-Term Sheet marketing efforts which justifies the relief they are seeking from this Court.

Consumer Privacy Under 11 U.S.C. § 363(b)(1)

6. The Motion does not provide sufficient information for the U.S. Trustee to determine whether a consumer privacy ombudsman needs to be appointed to protect personally identifiable information about individuals. 11 U.S.C. § 363(b)(1) provides:

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell

or lease personally identifiable information¹ to any person unless –

- (A) such sale or lease is consistent with such policy; or
- (B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease –

- (i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
- (ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

7. Under the Term Sheet appended to the Motion, the assets proposed to be transferred include “all (i) customer and client lists, vendor lists, catalogues, data relating to vendors, promotion lists and marketing data and other compilations of names and requirements, (ii) telephone numbers, internet addresses and web sites, and (iii) other material information related to Seller’s business.” The U.S. Trustee intends to determine whether the Debtors provide a privacy policy to consumers in connection with their business and, if so, whether the policy prohibits the transfer of personally identifiable information to third parties. The U.S. Trustee will report to the Court on this issue at

¹

“Personally identifiable information” is defined in 11 U.S.C. § 101(41A) as meaning

- (A) if provided by an individual to the debtor in connection with obtaining a product or a service from the debtor primarily for personal, family, or household purposes –
 - (i) the first name (or initial) and last name of such individual, whether given at birth or time of adoption, or resulting from a lawful change of name;
 - (ii) the geographical address of a physical place of residence of such individual;
 - (iii) an electronic address (including an e-mail address) of such individual;
 - (iv) a telephone number dedicated to contacting such individual at such physical place of residence;
 - (v) a social security account number issued to such individual; or
 - (vi) the account number of a credit card issued to such individual; or
- (B) if identified in connection with 1 or more of the items of information specified in subparagraph (A) --
 - (i) a birth date, the number of a certificate of birth or adoption, or a place of birth; or
 - (ii) any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically.

the hearing on the Motion and the related matter of whether a consumer privacy ombudsman should be appointed.

Break-Up Fee and Expense Reimbursement Provisions

8. Through the Motion, the Debtors are seeking approval of certain bid protections. In paragraphs 11 and 12 of the Motion, the Debtors state:

The APA and Term Sheet provide that the Seller will reimburse up to \$50,000 of Proposed Purchaser's fees and expenses (including, without limitation, legal costs and fees) incurred or to be incurred in connection with the consummation of the transaction (the "Guaranteed Expense Reimbursement"). Further, if Purchaser is designated as "stalking horse" under the Bid Procedures Order, but either: (a) Proposed Purchaser is not the successful bidder or (b) any of the Transferred Assets are transferred by Seller to any party other than Proposed Purchaser (whether pursuant to the Auction or otherwise), then Proposed Purchaser shall receive from Seller: (i) a cash breakup fee in the amount of \$780,000 (the "Breakup Fee"), and ([ii]) reimbursement of all expenses incurred by Purchaser, in an amount up to \$300,000 (the "Alternative Transaction Expense Reimbursement"), in both cases payable upon the earlier of consummation of a subsequent transaction to a party other than Proposed Purchaser or the entry of a final, non-appealable order confirming a Chapter 1 plan (an "Alternative Transaction"). In addition, without duplication, if the APA is terminated other than as a result of a material breach by Purchaser or the failure to be satisfied of a condition precedent to closing that is not caused by the material breach of Seller, and Seller is not obligated to pay the Breakup Fee, then Seller will nevertheless be obligated to pay the Alternative Transaction Expense Reimbursement to Purchaser up to a maximum of \$300,000. The Breakup Fee, Guaranteed Expense Reimbursement and Alternative Transaction Expense Reimbursement shall be treated as superpriority administrative expenses under 11 U.S.C. §§ 503 and 507(a) and paid in cash immediately when due or through the closing of an Alternative Transaction or when otherwise due and payable under the APA. (Footnotes omitted).

9. Initially, in the absence of an executed asset purchase agreement, this Court should not approve the requested bid protections, as an uncommitted bid does not deserve such protections.

10. Under the controlling decision by the United States Court of Appeals for the Third Circuit in Calpine Corp. v. O'Brien Environmental Energy, Inc. (In re O'Brien Environmental Energy, Inc.), 181 F.3d 527 (3d Cir. 1999), there are several problems with the Debtors' request to have bid protections approved:

(a.) First, the gross amount of the protections, taken together, are disproportionate to the present value of the bargain. The cash portion of the proposed transaction – \$10 million – is the only “sure” part of the proposal; the rest of the consideration to be paid by Proposed Purchaser comes in the form of: (i) a \$10 million financing commitment that, if tapped, will be a liability of the Debtors’ estates, (ii) an obligation to share the “upside” of the Linux litigation in an amount up to \$10 million (via a 20% interest in the proceeds realized from such litigation), and (iii) up to \$6 million in the form of a revenue sharing agreement related to the Hipcheck product line and Me Inc. Mobile which is tied to “non-guaranteed” sales targets. Per the Debtors’ public filings, the success of the Linux litigation hinges upon the Debtors’ ability to establish ownership of certain intellectual property rights, the same rights which the United States District Court for the District of Utah recently found were owned by Novell. Further, it is unclear whether Hipcheck and Me Inc. Mobile products are market-ready. Thus, the bid protections may actually exceed 10% of the present value of the consideration proposed to be paid under the transaction and, at a minimum, the protections significantly exceed the standard range of 2-3% which this Court has used as a benchmark to determine the appropriate amount of such protections.

(b.) Second, the payment “triggers” are unreasonable in three respects. First, Proposed Purchaser should not be receiving a guaranteed expense reimbursement; all fees should be tied to consummation of an alternative transaction. Second, the definition of an “alternative transaction”

should be restricted in two ways: (i) to the extent that the bid protections would be tied to the confirmation process, they should be tied to the effective date of a chapter 11 plan – not the confirmation of a plan; and (ii) there should be a time frame running from the bid deadline (i.e., three months) which limits the Debtors’ obligation to pay the bid protections – for example, if the cases convert to cases under chapter 7 and a trustee sells the assets at a liquidation price six months from now, the Debtors’ estates will not have received a benefit from the Proposed Purchaser’s “floor” bid in connection with such a sale. Third, to the extent that this Court approves reimbursement of Proposed Purchaser’s expenses, payment thereof should be subject to the U.S. Trustee’s review of documentation supporting the request.

(c.) Third, there is no legal basis for granting the proposed bid protections superpriority administrative expense status. 11 U.S.C. §§ 364(c) and 507(b) are the only sections of the Code which authorize superpriority claim status, and those sections address (i) the obtaining or incurring of debt in the event that the debtor-in-possession/trustee is unable to obtain unsecured credit and (ii) adequate protection of a secured claim which later proves to be inadequate. See 11 U.S.C. §§ 364(c), 507(b). Clearly, 11 U.S.C. §§ 364(c) and 507(b) do not apply to the bid protections which the Debtors propose to pay. Absent authority supporting the argument that this Court has the authority to elevate bid protections to superpriority administrative expense status, this Court should reject the Debtors’ proposal.

11. The Debtors’ request for “approval” of the asset purchase agreement is inappropriate. First, approval of the asset purchase agreement is a sale hearing issue. In the event that bid protections are approved, the appropriate sections of the asset purchase agreement may be referenced as “approved” in the bid procedures order.

12. In the event that this Court approves bid procedures, the procedures should expressly provide for the U.S. Trustee's rights to (i) inspect bids submitted in connection with the sale process and (ii) attend any auction held pursuant to the procedures.

13. The U.S. Trustee reserves the rights to be heard on and/or to object to any matters relating to the proposed sale, said matters being expressly reserved for a subsequent sale hearing.

CONCLUSION

WHEREFORE the UST requests that this Court issue an order denying the Motion or granting other relief consistent with this objection.

Respectfully submitted,

**KELLY BEAUDIN STAPLETON
UNITED STATES TRUSTEE**

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