UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	
	)	Chapter 11
The SCO Group, Inc., et al.,	)	
	)	Case No. 07-11337 (KG)
Debtors.	)	(Jointly Administered)

Ref. Docket No. 367

Objection Deadline: March 26, 2008 at 4:00 p.m. (prevailing Eastern time)
Hearing: April 2, 2008 at 2:00 p.m. (prevailing Eastern time)

NOVELL'S OBJECTION TO THE DEBTORS' MOTION TO APPROVE AN EXPENSE REIMBURESEMENT TO YORK

Novell, Inc., and its subsidiary, SUSE Linux GmbH ("SUSE" and together with Novell Inc., "Novell") object to the Debtors' Motion to Approve An Expense Reimbursement to York (the "Motion") of debtors and debtors in possession (the "Debtors") The SCO Group, Inc., and its wholly owned subsidiary, SCO Operations, Inc. (the "Debtors"). Last Winter, the Debtors asked for just such relief for York Capital Management ("York") in connection with their "emergency" motion to approve bidding procedures for a proposed sale of substantially all their assets to York, but they withdrew the request because they never did reach any kind of sale agreement with York. No matter, it seems, for now the Debtors seek an expense reimbursement for York anyhow. This request is a vintage performance by the Debtors in these cases, except that this time they seek to make an outright gift of the estates' assets rather than approval of just another really bad deal they have chased in ceaseless pursuit of their dreams of a litigation bonanza against Novell and others. The Court should deny the Motion.

I. BACKGROUND

A. Prepetition Events

Before commencing these cases, the Debtors conducted a software business. (Disclosure Statement in Connection with Debtors' Joint Plan of Reorganization (the "Disclosure Statement"

or "DS") 3-10.) A major aspect of the Debtors' business was litigation with various parties, including Novell. (DS 11-14; *see* Memorandum Opinion (filed herein November 27, 2007) (the "Opinion") 1-2.) One central piece of litigation was between Novell and SCO in the United States District Court for the District of Utah (the "District Court Litigation"). On August 10, 2007, Novell, Inc., won important rulings against SCO on partial summary judgment in the District Court. (DS 13-14; Opinion 3-4.) These rulings decided the key issues for Novell, leaving only Novell's counterclaims to fix compensation to try. (DS 13-14; Opinion 4.) The trial on the residual issues was set for September 14, 2007. (Opinion 4.) Having all but lost that litigation, and facing the prospect of an adverse judgment in the trial to begin after the weekend, the Debtors filed their voluntary chapter 11 petitions before this Court on September 14, 2007. (*Ibid.*) The filing stayed all SCO's litigation, including the Novell/SCO trial and, as this Court subsequently ruled, the Swiss-based arbitration between SCO and SUSE.

B. The "Emergency" Motion to Sell to York

Shortly after filing the cases, the Debtors attempted to sell substantially all their assets to York on an "emergency" basis. (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 (the "Sale Motion").) The Debtors also asked for an expense reimbursement in the event that York was not the winning bidder and for other stalking horse bidder "protections" for York.

What exactly the Debtors proposed to sell to York was not entirely clear – which was one of the fatal defects of the Sale Motion in the end – because the Sale Motion attached only a nonbinding term sheet rather than a definitive sale agreement. However, it was clear that among the assets the Debtors sought to sell was an interest in their various alleged claims against Novell and IBM, although the Debtors nominally retained control of the those proceedings. The proposed sale would have conferred on York a substantial share in the proceeds of the IBM and Novell, among other financial benefits. In return, York was to pay the Debtors "up to" $36

million, subject to reduction for various offsets that, upon inspection, threatened to all but swallow up the nominal purchase price. In addition, the Debtors asked the Court preliminarily to approve various "bidding protections" for York.

As Novell explained in Novell's Objection to Emergency Motion [etc.] (the "Sale Objection"), this proposed "emergency" deal came close to a trade by the Debtors of something for nothing. The purchase price of $36 million was illusory, the need for a breakup fee to attract bidders was unsubstantiated, the breakup fee was grossly excessive (a problem exacerbated by the addition of an expense reimbursement) and even the transaction itself was illusory because, among other things, the lack of sale documentation made it impossible to determine just what the Debtors were selling and whether they had the right to sell it light of their pending litigation with Novell. (Sale Objection 8-17.) Other parties in interest, including IBM and the United States Trustee, also objected to the Sale Motion.

Ultimately, without even getting to the bidding procedures issues, the Court rejected the Sale Motion because of the Debtors' inadequate disclosure of what the transaction comprised and because the Court recognized that the nature of the transaction required that the District Court Litigation be concluded so that what SCO had to sell would be clear. (*See* Transcript of November 16, 2007 hearing (filed November 27, 2007) (the "Transcript") at 38:1-39:15; Opinion 11 & n.7.)

Unable to get approval of the transaction without the making the key documents available (probably because they never existed), the Debtors finally withdrew the Sale Motion altogether just days later, on November 20, 2007). (Docket No. 225.) As the Debtors admit, "the negotiations between SCO and York did not reach a mutually satisfactory conclusion, the transaction failed . . . ." (Motion ¶ 3.) It appears, as well, that York walked from the proposed deal when its original blitzkrieg for approval of the sale turned into the prospect of a real, fair auction on a reasonable schedule. (*See* Transcript at 36-37, 47-48.) Hence, there was no auction, no sale and, most importantly, no approval of any expense reimbursement or other bidding protections for York

C. The Motion

Notwithstanding the fate of the Sale Motion, the Debtors nevertheless now seek an expense reimbursement for York of $150,000 (or $50,000, as an alternative) as a "business and moral matter". (Motion ¶ 4.) The Debtor do not explain why the issue is a "moral . . .matter" or how, even if it were, that Code authorizes the use of an estate's scarce resources for such a purpose.

According to the Debtors, the business aspect of the request arises because failure to pay the reimbursement to York will chill the interest of those who may be interested in the future in transactions with companies in bankruptcy. In making this claim, however, the Debtors ignore common knowledge that bankruptcy requires bankruptcy court *approval* of agreements out of the ordinary course, a point that the Debtors themselves acknowledge about bankruptcy law (*see* Motion ¶ 6). Moreover, this is a knowledge that one readily can attribute to York, a company its counsel described as sophisticated in bankruptcy transactions in the transcript excerpts Novell has cited above. Nor could anyone reasonably suppose that a party, whether sophisticated or not, that signed a term sheet that specifically required the approval of this Court for the expense reimbursement provisions somehow might think that it later could get such a reimbursement even though it did *not* meet the contemplated conditions for getting it. "Heads I win, tails you lose" does not pass muster in courts of equity such as this Court. And so much for the Debtors' "moral obligation" theory even if it had legal support.

Hence, factually the Debtors' argument is totally unpersuasive. It is also so legally, as Novell will explain next.

II. APPLICABLE LEGAL STANDARDS

The Debtors seek what amounts to payment of a breakup fee (one form of which is an expense reimbursement) as an administrative expense under Code section 503(b) to York; in these circumstances, there really is no other source in the Code that potentially could authorize the relief the Debtors seek for York here. *See Calpine Corp. v. O'Brien Envtl. Energy Inc. (In re*

O'Brien Envtl. Energy, Inc.), 181 F. 3d 527, 531-32 (3d Cir. 1999). Accordingly, the law governing the award of expenses of administration governs the Motion:

> [T]he determination whether break-up fees or expenses are allowable under § 503(b) must be made in reference to general administrative expense jurisprudence. In other words, the allowability of break-up fees, like that of other administrative expenses, depends upon the requesting party's ability to show that the fees were actually necessary to preserve the value of the estate.

Calpine, 181 F.3d at 535. Accordingly, the Court must carefully consider the propriety of any "bid protections." Thus, "the allowability of breakup fees, like that of other administrative expenses, depends on the prospective purchaser's ability to show that the fees were actually necessary to preserve the value of the estate." *Ibid*; *see also In re Beth Israel Hosp. Ass'n of Passaic*, 207 WL 2049881 at 12 (Bankr. D. N.J. 2007) (citing *Calpine*, 181 F.3d at 535) (failure to show breakup fee was needed to attract bidders). Finally, the party seeking the award of an administrative expense bears a heavy burden of proof to justify the relief it seeks. *Calpine*, 181 F.3d at 533; *In re Women First Healthcare, Inc.*, 332 B.R. 115, 121 (Bankr. D. Del. 2005). One particular factor the Court should consider in deciding the necessity of break-up fees is whether they are reasonable in light of the purchase price. *See Integrated Resources, Inc.*, 147 B.R. 650, 662 (S.D.N.Y. 1992) (enunciating factors to consider in approval of bid protections).[1]

It also is possible to see this otherwise remarkable Motion as a species of a sale of assets out of the ordinary course under Code section 363(b). In proposing a 363 asset sale, the debtor must establish, and the Court must determine, that there is a "sound business justification" for the sale. *See In re Del. & Hudson Ry. Co.*, 124 B.R. 169, 176 (D. Del. 1991) ("Once a Court is satisfied that there is a sound business reason or an emergency justifying the pre-confirmation sale, the Court must also determine that the trustee has provided the interested parties with adequate and reasonable notice, that the sale price is fair and reasonable and that the purchaser is

[1] Technically, the party wanting to recover the alleged administrative expense – in this case York – should be requesting the payment rather than the Debtors. *In re McNitt*, 170 B.R. 706, 707 (Bankr. D. Idaho 1994).

proceeding in good faith"); *see also In re Lionel Corp.*, 722 F.2d 1063, 1068-69 (2d Cir. 1983) (finding no sound business reason for proposed 363 sale).

Under either rubric, the Motion should be denied.

III. THE MOTION SHOULD BE DENIED

The Motion clearly fails to meet the standards for approval of a breakup fee or a section 363(b) sale. There has been no benefit to the Debtors' estates. York's participation in the process did not attract any other bidders; indeed, it did not result in a sale to anyone, including York. In fact, it did not even result in signed contract between York and the Debtors. In fact, , to the contrary, all that happened is that the Debtors spent money needlessly on a proceeding that was, to all intents and purposes, stillborn had it not been for the stubbornness of the Debtors' management and the avarice of York. Far from preserving the estate, the Debtors and York caused its diminution through the Sale Motion. And, of course, it warrants noting that creditors such as Novell had to spend their own funds opposing the ill-starred Sale Motion, as well. Additionally, there is neither factual nor common sense support for the Debtors' theory that the Court's failure to grant the Motion will chill interest in buying these Debtors' assets or any debtor's assets in the future, especially not interest by sophisticated parties such as York.

Under these circumstances, moreover, the Motion reflects not sound business judgment, but a total lack of any judgment at all. No debtor can make a gift of estate money such as the Motion effectively represents. *See, e.g., Mazur v. Byrd (In re Priestly)*, 94 B.R. 195, 198 (Bankr. D.N.M. 1988); *In re Everetts*, 71 B.R. 110-111-112 (Bankr. D. Colo. 1987). For the same reason the proposed award represents not a fair price, but a gratuity by the Debtors.

IV. CONCLUSION

For the reasons explained above, the Court should deny the Motion as the Debtors' worst and least supported idea yet in these cases.

Dated: March 26, 2008
Wilmington, Delaware

YOUNG CONAWAY STARGATT & TAYLOR, LLP

/s/ Sean T. Greecher

James L. Patton (No. 2202)
Michael R. Nestor (No. 3526)
Sean T. Greecher (No. 4484)
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, Delaware 19899-0391
Telephone (302) 571-6600

-- and --

MORRISON & FOERSTER LLP
Adam A. Lewis
425 Market Street
San Francisco, California 94105-2482
Telephone (415) 268-7000

-- and --

MORRISON & FOERSTER LLP
Larren M. Nashelsky
Julie Dyas
1290 Avenue of the Americas
New York, New York 10104-0050
Telephone (212) 468-8000

Counsel for Novell, Inc.