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. 394

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 FOR ORDER (I) SCHEDULING CONFIRMATION HEARING [ETC.]

Novell, Inc., and its subsidiary, SUSE Linux GmbH ("SUSE" and together with Novell Inc., "Novell") object to the Debtors' Motion for Order (I) Scheduling Confirmation Hearing [etc.] (filed March 11, 2008 (the "Motion") because it proposes noticing and balloting procedures that treat Novell as unimpaired and, therefore, unable to vote on the debtors' proposed plan of reorganization. However, because the debtors' plan impairs Novell, the Motion must be denied because it perpetuates the plan's attempt to deny Novell its voting rights.

I. BACKGROUND

A. General History

Resolution of the Motion requires some minimal background information about these cases and the plan.

Debtors and debtors in possession (the "Debtors") The SCO Group, Inc. ("SCO"), and its wholly owned subsidiary, SCO Operations, Inc. ("Operations"), conduct a software business. (proposed Disclosure Statement in Connection with Debtors' Joint Plan of Reorganization (the "Disclosure Statement" or "DS") 3-10.) SCO was involved in litigation against various parties, including Novell. (DS 11-14; *see* Memorandum Opinion (filed herein November 27, 2007) (the "Opinion") 1-2.) Probably the key 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.) That left only Novell's counterclaims against SCO to try. (DS 13-14; Opinion 4.) The trial on those residual issues was set for September 14, 2007. (Opinion 4.) Having all but lost that litigation, and facing an adverse judgment of the District Court Litigation in the trial to begin after the weekend, SCO and Operations filed their voluntary chapter 11 petitions before this Court on September 11, 2007. (*Ibid.*) The filing stayed all SCO's litigation, including the Novell/SCO litigation and – as the Court later found – the SCO/SUSE arbitration in Switzerland.

On February 29, 2008, the Debtors, having obtained an unopposed extension of their exclusivity periods under Code section 1121, filed the Debtors' Joint Plan of Reorganization (the "Plan") and Disclosure Statement.

B. The Plan Impairs Novell

1. SNCP's (Purported) Financing

The Plan presupposes debt and equity financing purportedly to be provided by the plan sponsor, an entity called Stephen Norris Capital Partners LLC ("SNCP"). (Plan 3, 4, 13; DS 19-20, 36-37.) Under the Plan, SNCP will invest $5 million of equity in the Debtors immediately upon confirmation of the Plan and "commit" to lend up to another $95 million under a non-revolving loan for up to five years at 17% over LIBOR interest rate (probably around 20% with LIBOR). SNCP will get a security interest in all of the Debtors' assets to secure the loan. The Debtors will remain in business with all of their assets, including intellectual property and litigation claims. The Plan refers parties in interest to a Memorandum of Understanding (the "MOU") between SCO and SNCP for further details on SNCP's role in the Plan.

Notably, neither the Plan nor the Disclosure Statement provides much information about SNCP. The Disclosure Statement recites that SNCP was founded by Stephen Norris & Co. Capital Partners, L.P. ("SNCC") "for the purposes of this transaction [the Plan]." (DS 18.) It has a brief statement about SNCC's partners, Stephen Norris and Mark Robbins, and sweeps breezily through a short statement of some of their past activities, making some very general grand claims about their past successes. (DS 19.) Beyond that, the Disclosure Statement says nothing about Norris, Robbins, SCNP or SNCC, including the capitalization or other access to funds of the latter two. On that last subject, the only "information" is the MOU's statement that SNCP has a "financing commitment" that is "sufficient" and that SNCP "will provide the Debtor [no mention of the Court or parties in interest] with a firm financing commitment" at least five days before the hearing on the Disclosure Statement. (MOU 3.)

Similarly, neither the Plan nor the Disclosure Statement provide any detail on what the terms and conditions are in the proposed line of credit even though the particulars are potentially crucial to creditors, the Debtors tell the Court and parties in interest that on the Plan's Effective Date, "the Company [the Debtors] shall enter into loan and security agreements and other related documents with SNCP (the "Loan Documents") to make the Loan available to the Company on the following terms . . . ." (DS 36.) Certain of the terms thus referenced are laid out (DS 36-37), but the Loan Documents, including any other covenants or conditions precedent to SNCP's obligation to make advances, are nowhere to be seen. Instead, the Debtors say they will file those materials on these critical questions only shortly before the hearing on the Disclosure Statement. (*See* Debtor's Motion to Approve Settlement Compensation or Sale Compensation and Expense Reimbursement to Plan Sponsor (the "Sponsor Motion") 1.)

2. Continuation of the Business and Other Uses of Funds

The Debtors will remain in the software business. They will continue to prosecute and defend their litigation with Novell and others. The Debtors will use the loan and equity funds supplied by SNCP (along with their other existing and future cash, if any) to underwrite all aspects of the Plan, including continuation of litigation (including the provision of any appeal bonds or like security), continuation of other operations, treatment of equity and payment of creditors, as described below.

3. Treatment of Equity as Impaired

SCO's equity structure will change in that SNCP will own virtually all of it from the start, and all of it in the end.[1] Existing equity will get some cash shortly after the Effective Date and perhaps some more later, but eventually it will be squeezed out by SNCP. The Plan treats holders of equity interests in SCO – Class 5 -- as the *only* class of claims or interests that is impaired under Code section 1124. (Plan 9-13; Motion 5-7, 9 & Exs. A, B, C.)

4. Payment of Creditors Generally

The Debtors will use the SNCP equity and debt to pay creditors in full on their claims once they are allowed. Undisputed claims will, therefore, be paid on the Effective Date. Claims that are disputed will be paid if and when they are allowed. As Novell will describe shortly, holders of certain kinds of disputed claims will face certain potential obstacles to payment that other creditors do not. (Plan 9-11, 13, 15, 19-20; DS 36-37, 41-42.)

5. The Detail of the Plan's Provisions for Payment of Pending Litigation Claims Impair Novell

As previously noted, the Plan treats all classes of unsecured creditors as unimpaired under Code section 1124 even though holders of disputed claims, and holders of pending litigation claims especially, are treated differently than holders of claims that are undisputed on the Effective Date.

Operations will be revested with its estate upon the Effective Date. (Plan 15.) Operations also will be the Plan's Disbursing Agent for payment of allowed claims. (Plan 3.) The Plan sets up a reserve for disputed claims other than the claims in the litigation with Novell and others. (Plan 19.) All those holding general unsecured claims except the holders of pending litigation claims, are, therefore, assured of full payment via payment on the Effective Date or from the reserve once their claims are allowed.

[1] Only SCO itself is directly implicated in this aspect of the Plan, as it simply will continue 100% ownership of Operations.

However, the Plan separately classifies pending litigation claimants as Class 4, and they are subjected to a different – and riskier – regime for payment of their claims once allowed. When the claims are allowed by final order or settlement, the Plan relies on the availability of other finds or funds under the SNCP line of credit for payment rather than on an existing reserve. (*See* Plan 11, 19-20.) Hence, holders of pending litigation claims, such as Novell, must rely on the availability of any leftover cash (from the reserves or other sources) and the prospect of continued availability of the SNCP line of credit for assurance of payment of those creditors' allowed claims. (*See* Plan 20.) They are not paid on the Effective Date and they are not the beneficiaries of the reserve for payment of other disputed claims. Nor is this a minor disability, for as Novell has explained previously, there is virtually no information in the Disclosure Statement or Plan about SNCP and SNCC's financial resources and historic performance or about the terms and conditions of the relevant financing agreements, leaving indicated creditors to speculate about whether they will be able collect from SCO or SNCP when the time eventually comes.

Moreover, the Plan adds yet another burden to this differential treatment of the pending litigation claimants. It specifies that the automatic stay of Code section 362(a) remains in place through a delay in the revesting of SCO's estate until the earlier of the allowance or disallowance of the last of the pending litigation claims or an election to revest by SCO. (Plan 15, 20; DS 37-38.) In other words, if any pending litigation claimant cannot get paid in full (voluntarily or otherwise) by the Debtors when its claim is allowed, its only remedy is to seek stay relief from the Court to reach SCO's protected assets unless it is the last such claimant to have its claim allowed (or SCO has elected to revest sooner). Among all creditors, *only* pending litigation claimants such as Novell face this additional hurdle to payment when their claims are allowed.

II. THE MOTION

By the Motion, the Debtors ask the Court to set a hearing on confirmation of the Plan and to approve various related confirmation procedures. For purposes of this objection, the relevant provisions of the Motion are those that follow from the Plan's treatment of Class 4 disputed pending litigation claims and its assertion that those claims are unimpaired. In particular, the Motion (and Plan) seek to prevent Novell from voting. (Plan 11Motion 5-7, 9 & Exs. A, B, C.) It is this aspect of the Motion to which Novell objections because, as Novell will show, despite the Debtors' claims, the Plan on its face impairs Novell (and all others in Class 4).

III. NOVELL (CLASS 4) IS ENTITLED TO VOTE ON THE PLAN BECAUSE IT IMPAIRS NOVELL

As noted above, the Plan, Disclosure Statement and Motion claim that as a member of Class 4 Novell is unimpaired and, therefore, denied the power to vote on the Plan. The Motion thus seeks approval of ballots and confirmation noticing procedures that also purport to deny Novell and the rest of Class 4 a vote on the Plan. But the Plan *does* impair Class 4, so the Motion must be denied.

The Third Circuit has explained impairment under Code section 1124(1):

> "Impairment" is a term of art crafted by Congress to determine a creditor's standing in the confirmation phase of bankruptcy plans. *In re L & J Anaheim Assoc.*, 995 F.2d 940-942-43 (9th Cir. 1993). Each creditor has a set of legal, equitable, and contractual rights that may or may not be affected by bankruptcy. If the debtor's Chapter 11 reorganization plan does not leave the creditor's rights entirely "unaltered," the creditor's claim will be impaired under § 1124(1) of the Bankruptcy Code. . . .
>
> The Bankruptcy Code creates a presumption of impairment . . . .[Citations omitted.] Under 11 U.S.C. § 1124(1), the presumption of impairment is overcome only if the plan "leaves unaltered the [creditor's] legal, equitable, and contractual rights." [Footnote omitted.] The burden is on the debtor to demonstrate that the plan leaves the creditor's rights unaltered.

In re PPI Enterprises (U.S.), Inc., 324 F.3d 197, 202-03 (3d Cir. 2003). In setting forth this standard, the Third Circuit distinguishes between impairment by the plan and impairment by the Code (or what it calls "by statute"). *Id.* at 204-05. Only the former is the kind of impairment section 1124(1) contemplates. Examples of the latter are plans that reflect the Code's *mandatory* capping of a landlord's claim in section 502(b)(6) and equally *mandatory* subordination of certain kinds of securities claims in section 510(b). *Ibid.*

Normally, a creditor obtaining a money judgment against a defendant would be entitled to begin executing on that judgment unless the defendant posts security or a supersedeas bond. Of course, while the automatic stay of Code section 362(a) is in place, the creditor is prevented from proceeding thus. But confirmation of a plan usually effects a termination of the stay as to proceeding against the reorganized debtor's property to collect on claims if they are not paid. That is because of the interplay between Code sections 1141(b) and 362(c)(1). Under Code section 362(c)(1), the stay ordinarily terminates when property no longer is property of the bankruptcy estate created by Code section 541. And under Code section 1141(b), confirmation of a plan normally revests a debtor with property of the estate. In such circumstances, the revested property, no longer being estate property, also no longer is protected by the stay.

The Plan, however, deprives Novell of its standard right to recover on a money judgment upon entry absent the posting of security or a supersedeas bond by SCO. It achieves this result by artificially postponing revesting of the SCO's estate in SCO, as described above, thus affording SCO continued protection of the stay. This deprivation is of additional significance because Novell will be forced to depend on SNCP's future commitment to and ability to provide financing to pay Novell's judgment some time down the road, a commitment on which the Disclosure Statement not only is essentially silent, but for which what evidence there is creates doubt. SCO nevertheless argues that the Plan in this regard does not impair Novell. SCO's theory, it appears, is that the impairment of Novell is statutory rather than plan-generated because it is accomplished through the delay of revesting of SCO's estate via Code section 1141(b).

However, SCO mistakenly assumes that any impairment accomplished under any provision of the Code is statutory. But that is not what *PPI Enterprises* says. Rather, *PPI* says that impairment is statutory when the application of the statute is *mandatory*, as in the case of the cap on landlord's claims or the subordination of securities claims. By contrast, the Debtors' employment of delay in revesting after confirmation is not mandatory, but permissive. Code section 1141(b) allow*s* a plan to delay revesting, but it does not *require* that it do so. Indeed, by section 1141(b)'s very terms ("[e]xcept as otherwise provided in the plan"), revesting at confirmation is the norm. Indeed, the Debtors' theory would make *all* impairment statutory rather than plan-effected because the Debtors' very power to impair claims is itself a statutory creation that is permissive rather than mandatory under Code section 1123(b)(1) ("a plan *may* . . . impair or leave unimpaired any class of claims") (emphasis added)). On the Debtors' theory, impairment itself is simply taking advantage of anything already in the Code, no matter what its nature, that a debtor can do to creditors.

Another way to see this same point is to look at the policy underlying the concept of impairment as enunciated by *PPI Enterprises*. That policy treats claims as impaired unless the debtor can establish that they are unimpaired. In short, it serves the objective of giving creditors a say about a plan unless it does not affect them at all. Here, common sense and fairness say that a creditor that is deprived of its normal right to enforce a judgment outside of bankruptcy (in this instance, post-confirmation) is impaired and should be able to vote.

IV. CONCLUSION

The Plan and Motion deny Novell and other Class 4 creditors a vote on the Plan on the theory that the Plan does not impair Class 4 creditors. But as Novell has just shown, the Plan *does* impair Class 4 by burdening the members' normal entitlement to execute on a judgment absent the posting of proper security; instead, the Plan's provision for delay of revesting artificially preserves the automatic stay, making Class 4 rely on its chances with whether SNCC's credit is good some day. For this reason, the Motion seeks relief that must be denied.

Dated: March 26, 2008
Wilmington, Delaware

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