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)

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' PROPOSED DISCLOSURE STATEMENT

Novell, Inc., and its subsidiary, SUSE Linux GmbH ("SUSE" and together with Novell Inc., "Novell") object to the proposed Disclosure Statement in Connection with Debtors' Joint Plan of Reorganization (the "Disclosure Statement" or "DS") because the Disclosure Statement is more like Rosemary Woods' famous missing 18 minutes of tape than a document designed to provide the "hypothetical investor . . . [adequate information upon which] to make an informed judgment about the plan." Code[1] 1125(a)(1): Just when it really counts, the Disclosure Statement goes silent. Creditors will have no idea what they are getting if they vote for this plan because the Disclosure Statement leaves them completely in the dark about the plan's newly-formed sponsor and alleged financial benefactor, along with other important matters. Nor is this the first glaring gap in the "tapes" the debtors have played for the Court and parties in interest in theses cases in the debtors' headlong rush to make a deal with *someone*. Moreover, the Plan is unconfirmable on its face because it incorrectly treats Novell as unimpaired and, therefore, unable to vote on the Plan. The Court should deny approval of the Disclosure Statement for this (and other) reasons.

[1] The Code is the Bankruptcy Code, 11 U.S.C. §§ 101-1552. As well, in this brief, "Rule __" will refer to a rule of the Federal Rules of Bankruptcy Procedure.

I. BACKGROUND

A. General Procedural History

Before filing these chapter 11 cases, debtors and debtors in possession (the "Debtors") The SCO Group, Inc. ("SCO"), and its wholly owned subsidiary, SCO Operations, Inc. ("Operations"), conducted a software business. (DS 3-10.) SCO was involved in litigation against various parties, including Novell, IBM Corporation ("IBM"), Red Hat and Autozone involving SCO's claims that they were interfering with its alleged ownership of certain UNIX code copyrights that are central to SCO's business. [2] (DS 11-14; *see* Memorandum Opinion (filed herein November 27, 2007) (the "Opinion") 1-2.)

Probably the key litigation was between Novell, Inc. 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 its litigation with Novell, Inc. and facing the prospect of the *coup de grace* in the trial to begin after the weekend, SCO and Operations filed their voluntary chapter 11 petitions before this Court. (*Ibid.*) The filing stayed all SCO's litigation, including the Novell/SCO litigation and – as this Court later found – the Zurich arbitration between SUSE and SCO.

Since filing these cases, the Debtors have had their attempt to sell substantially all their assets to York Capital Management ("York") rejected by the Court because of the Debtors' inadequate disclosure of what the transaction comprised (there was not even an *un*executed sale agreement, let alone an *executed* one) and because the Court recognized that the general nature of the transaction required that the District Court Litigation be concluded so that what SCO had

[2] The discussion of the disputes between SCO, on the one hand, and Novell and other parties, on the other hand, are highly simplified in this brief since their precise counters are not material to the issues before the Court on this occasion.

to sell would be clear. (*See* Transcript of November 16, 2007 hearing (filed November 27, 2007) at 38:1-39:15; Opinion 11 & n.7.)[3] With the latter issues and the need to fix Novell's claim in mind, in part, the Court later granted Novell's motion for stay relief to complete the District Court Litigation, including any appeals. (Opinion; Order Granting Novell's Motion for Relief [etc.] (filed November 27, 2007).) Subsequently, the Debtors brought yet another motion – the Cattleback settlement motion – whose limited disclosures also required supplementation before the Court could approve them. (*See* Docket Nos. 194, 234, 251, 252, 254.)

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 the Disclosure Statement, noticing a hearing on the adequacy of the Disclosure Statement. The Debtors recently noticed a hearing on their motion to set a hearing on and procedures for confirmation of the Plan (the "Plan Motion"). The hearings on the Disclosure Statement, Plan Motion and several other related motions all are set for April 2.

B. The Plan: General Outline

1. Plan Financing and Sponsor

The centerpiece of the Plan is debt and equity financing to be provided by the plan sponsor. (Plan 3, 4, 13; DS 19-20, 36-37.) The plan sponsor is an entity called Stephen Norris Capital Partners LLC ("SNCP"). 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 (a whopping) 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.

[3] Unable to get approval of the transaction without making the key documents available (probably because they never existed), the Debtors finally withdrew their sale motion altogether just days later, on November 20, 2007). (Docket No. 225.)

Notably, the Disclosure Statement provides virtually no information about SNCP. It 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, it 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 of the proposed line of credit are even though, as in documenting any distressed loan (indeed, in any loan at all), the devil is in the details. Rather, in an approach reminiscent of their attempt to sell their assets to York and to settle claims with Cattleback, 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 "<u>Loan Documents</u>") 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.)

The Disclosure Statement provides no explanation why the relevant materials will not be available sooner. That the materials were not available suggests that in proceeding with the Plan and Disclosure Statement, along with the motion to give SNCP a slice of any preconfirmation settlement (*see* Sponsor Motion), the Debtors have again jumped the gun. They have put "action" ahead of sound judgment and *meaningful* negotiations, as the Debtors did with the York sale motion.

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. In addition, the Debtors will continue in their software business. 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

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.[4] 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 equity as the only impaired class. (Plan 9-11, 13-15; DS 19-35, 41-42.)

4. Payment of Creditors

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 potential obstacles to payment that other creditors do not. (Plan 9-11, 15, 19-20; DS 36-37, 41-42.)

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

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

The Plan's mechanisms governing payment of Novell's claims are important to the Court's consideration of the Disclosure Statement. Accordingly, Novell will elaborate on them here. 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. Operations also will be the Plan's Disbursing Agent for payment of allowed claims. The Plan sets up a reserve for disputed claims other than the claims in the litigation with Novell and others. 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.

However, the Plan separately classifies pending litigation claimants, 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. 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 their allowed claims. They are not paid on the Effective Date and they are not the beneficiaries of the reserve for payment of other disputed claims.

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. 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).[5] Among all creditors, *only* pending litigation claimants such as Novell face this additional hurdle to payment when their claims are allowed. Curiously, although the Debtors say in the Plan that the purpose of the SNCP alleged $95 million line credit includes payment for appeal bonds, they also expressly tout this revesting mechanism as a way to avoid having to post such a bond.[6]

II. SUMMARY OF THE LAW OF DISCLOSURE STATEMENTS

Code section 1125(b) provides that:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan, or a summary of the plan, and a written disclosure statement approved, *after notice an a hearing*, by the court as containing *adequate information.*

(Emphasis added.) In turn, section 1125(a)(1) defines "adequate information" as being:

> [i]nformation of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records . . . that would enable a hypothetical [creditor of or investor in the debtor] of the relevant class to make an informed judgment about the plan . . . .

There are many general formulations concerning the purpose of a disclosure statement, and given the case-by-case analysis that courts must apply and the flexibility courts have in assessing proposed disclosure statements, it is not meaningful to try to provide more than general account of that purpose. A typical explication is:

[5] Given these considerations, one must ask why SCO *ever* would make such an early election? In essence, the early election option is an illusion.

[6] Why the Debtors and SNCP need such a provision to avoid paying the cost of a supersedeas bond premium out of a $95 million line of credit is perhaps the first symptom that something is not quite right with the whole SNCP picture. This suggests that SNCP will do everything it can to avoid lending a dime for any purpose. That is an important fact that highlights the significance of some of the Disclosure Statement's omissions that Novell discusses in this brief.

> The general purpose of the disclosure statement is to provide 'adequate information' to enable 'impaired' classes of creditors and interest holders to make an *informed* judgment about the proposed plan and determine whether to vote for the plan.

In re Phoenix Petroleum Co., 278 B.R. 385, 392 (Bankr. E.D. Pa. 2001) (emphasis added); *see also, e.g., In re Monroe Well Service, Inc.*, 80 B.R. 324, 330 (Bankr. E.D. Pa. 1987).

Notwithstanding the general nature of section 1125's test for the adequacy of a disclosure statement, certain observations are possible. Indeed, some courts have composed lists of subjects a disclosure statement generally should cover. Such a case is *In re Cardinal Congregate I*, 121 B.R. 760, 765 (Bankr. S.D. Ohio 1990). Among the considerations listed there that are of particular relevance to this case are: a chapter 7 liquidation analysis; valuations or *pro forma* projections of future performance; and "[i]nformation relevant to the risks being taken by creditors and interest holders." Accordingly, a disclosure statement should illuminate financial aspects of the plan. *See, e.g., In re Monroe Well Service, Inc.*, 80 B.R. at 330, 332("[s]ufficient financial information must be provided so that a creditor (likened to a 'hypothetical reasonable investor') can make an 'informed judgment' whether to accept or reject the plan", disclosure statement must disclose conditions precedent to funding of plan by nondebtor and must also disclose information about resources of funding guarantor so that creditors can evaluate credit enhancement guarantee represents).

Finally, a court should not approve a disclosure statement if the underlying plan is unconfirmable on its face because approving the Disclosure Statement and proceeding to confirmation would be futile and a waste of judicial and other resources. *E.g., In re Cardinal Congregate I*, 121 B.R. at 764; *In re Monroe Well Service, Inc.*, 80 B.R. at 333.

III. THE DISCLOSURE STATEMENT SHOULD NOT BE APPROVED

A. The Disclosure Statement Omits Critical Information About SNCP and the Line of Credit

Given the terms of the Plan, detailed information about SNCP, its own finances and the line of credit is crucial. After all, SNCP as the majority owner will be the effective manager of the Debtors as of the Effect Date, and it will also be the Debtors' financial fount. Interested parties will want to know who (or what) is SNCP? What is its history; who are its managers and what are their experience and history? On these questions depend in part the ability of parties in interest to evaluate the bona fides and reliability of the "offer" to them that the Plan contemplates. And yet, there is effectively no information about any of these matters in the Disclosure Statement.

Similarly, SCNP's willingness and ability to fund the initial equity infusion of $5 million and the line of credit thereafter are vital. If the same SNCP that wants the Plan to use delayed revesting as way of sparing it from paying for a supersedeas bond out of its supposed $95 million line of credit cannot or will not perform, the Plan exists only at mere sufferance for all concerned (except perhaps SNCP and SNCC), and Novell and other litigation defendants, equally, may find that there is no money left or available to pay them if they win their litigation. Yet, in the Disclosure Statement there is no financial information about SNCP. Does it have the money now? If not, how and where will it get it? If it must get it elsewhere, what are the conditions and obstacles to its being able to do so? Indeed, there is a prior question: even if SNCP has access to Fort Knox, what conditions and covenants will there be in the loan agreement between it and the Debtors that might enable SNCP to terminate the line of credit prematurely? Once again, the Disclosure Statement fails to shed any light whatsoever on *any* of these questions. Indeed, so far, the parties do not even have the loan agreement and other documents to review.[7] It truly is hard to imagine a more inadequate disclosure statement than this one on these critical points.

The Plan indicates that shortly before this hearing the Debtors will file documents that may address some of the information deficits. However, Rule 3017(a) requires a minimum of 25 days' notice for a hearing on a disclosure statement. The submission of information just days before such a hearing does not meet that minimum notice requirement, especially when that information, if it even purports to be complete, will require careful review and analysis.

[7] Clearly, the issues Novell has just discussed foreshadow feasibility issues – among others – under Code section 1129(a)(11) at confirmation (if the parties get to confirmation), as well.

B. The Disclosure Statement Lacks Projections

The Disclosure Statement provides no projections of the Debtors' financial performance post-confirmation. Although it is – perhaps – difficult for the Debtors to predict the financial outcome of the litigation they are going to prosecute post-confirmation, the Plan also contemplates that the Debtors will continue in their software development business. Yet, the Debtors do not even make projections about that part of their post-confirmation existence. That information is of potential consequence. For example, it will help parties in interest to assess whether that part of the Plan is genuine, or merely a cover for keeping existing management on the payroll for some reason. The Debtor should provide meaningful projections in the Disclosure Statement.

C. The Liquidation Analysis Is Questionable

The Debtors' liquidation analysis (Exhibit 11 to the Disclosure Statement) is suspect. On the one hand, the entire Plan is built around the notion (reaffirmed by the Debtors in the Disclosure Statement at 14) that the litigation against Novell, IBM and others is valuable notwithstanding the rulings of the District Court. On the other hand, in the liquidation analysis the Debtors attribute *no* value at all to the litigation. The implication is that the litigation has no value in anyone's hands at all other than SCO/SNCP, and, in particular, in the hands of a chapter 7 trustee. SCO and SNCP should explain and rationalize this binary, heads-I-win-tails-you-all-lose valuation.

D. The Plan Is Not Confirmable Because It Incorrectly Characterizes Novell as Unimpaired

As noted above, the Plan and Disclosure Statement claim that Novell is unimpaired and, therefore, purport to limiting voting for confirmation to the only class that the Debtors concede is impaired: the equity holders. On this point the Debtors are simply wrong. Accordingly, the Plan on its face cannot be confirmed, and so the Court should disapprove the Disclosure Statement. 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).

SCO's is wrong. SCO 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

In essence, the plan is little more than an invitation to creditors and shareholders to speculate on supporting continued litigation against Novell and various other defendants in the hope that they will get some small slice of any jackpot. The Plan makes no serious commitment to the continuation of the software business as such. In noting this, Novell does not suggest that such a plan is improper. Rather, Novell's point is that to make an informed judgment on whether to take such a flyer rather than insist on some other kind of plan or resolution of these cases, creditors and shareholders must get better disclosure than dreamy investors in penny stock might be willing to accept before leaping. The Disclosure Statement does not even come close to giving them that. Indeed, as noted at the outset of this brief, it all but evaporates when it comes to this kind of crucial information. And even if it did provide adequate information, it would provide it for a plan that is patently unconfirmable. For these and the other reasons discussed above, the Court should deny approval of the Disclosure Statement.

Dated: March 26, 2008
Wilmington, Delaware

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