

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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

Hearing: September 16, 2008 at 10:00 a.m. (prevailing Eastern time)
Related Docket Nos. 525 and 541

**DEBTORS' REPLY TO NOVELL'S RESPONSE TO
DEBTORS' THIRD MOTION TO EXTEND EXCLUSIVITY**

The above captioned Debtors reply to *Novell's Response to Debtors' Third Motion to Extend Exclusivity* ("Novell Response") to state, among other things, that: (1) it is not the fact of the Novell Litigation itself, but the market reaction as experienced by the Debtors, along with other facts and circumstances that constitute "cause" to extend the Debtors' exclusive periods; and (2) the Debtors are not requesting that the Court extend the Debtors' exclusive periods beyond that imposed by the Bankruptcy Code. In further support of the *Third Motion by Debtors Under Section 1121(d) for Extension of Exclusivity Deadlines* (the "Motion"), the Debtors state:

Introduction

The Debtors are certainly capable of proposing a plan of reorganization that solves for contingencies. However, it has always been the Debtors' goal to propose a plan that will allow them to exit bankruptcy with creditors paid in full with interest and equity security holders retaining their interests, and to do so with a fully negotiated and binding transaction at the time of proposing the plan, as opposed to filing the plan with a contingent framework without a transaction partner. The Debtors have been working in good faith to secure a transaction to achieve those goals. The Debtors have presented a couple of proposals to this Court to help reach this goal. Novell has objected to or expressed concerns regarding those proposals. There are

several reasons why the Debtors believe that they have not been able to present a confirmable plan to date. One reason is that the downturn in the economy has impacted the financial markets, which has impacted the Debtors' ability to access capital. Another, more fully elaborated in the Motion, is that the August 10, 2007 summary judgment ruling in the Novell Litigation¹ raises certain questions as to what rights SCO Group had in its business which, in turn, impacts how potential investors view and value the Debtors' business. Finally, Novell continues to use legal tactics to delay or avoid appellate review of that ruling.

Exclusive Periods Should be Extended

1. The determination of "cause" is fact and case specific. *In re Dow Corning Corp.*, 208 B.R. 661, 664 – 665 (Bankr. E.D. Mich. 1997) (citing *In re Express One Int'l, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996)); *In re McLean Indus., Inc.*, 87 B.R. 830 (Bankr. S.D.N.Y. 1988); *In re Wisconsin Barge Line, Inc.*, 78 B.R. 946 (Bankr. E.D. Mo. 1987)). The Debtors will not repeat the factors discussed in the Motion, but emphasize that the lack of finality surrounding the August 2007 Ruling, coupled with the other factors referenced in the Motion and herein, constitute "cause."

2. As stated in the Motion, after conducting a four-day bench trial in late April and early May of this year, on July 16, 2008, the Utah District Court entered the July 2008 Ruling. In that ruling, the Utah District Court concluded that SCO Group was entitled to enter into the 2003 Microsoft Agreement and the other SCOSource Licenses and awarded Novell the principal sum of \$2,547,817, an amount significantly less than the approximately \$30 million plus interest reflected in the proof of claim Novell filed in connection with these bankruptcy cases. The District Court also requested briefing from the parties on the issue of prejudgment interest.

¹ Capitalized terms not otherwise defined have the meaning ascribed in the Motion.

3. The July 2008 Ruling also directed Novell to submit a final judgment consistent therewith, so that, among other things, appeals could be taken from the District Court's rulings. However, Novell did not submit a final judgment and instead filed a response indicating that a final judgment could not be entered because several of SCO Group's claims remain stayed and unresolved pending the SuSE arbitration and because Novell's claim for constructive trust is to be adjudicated by this Court. Novell asserted that the SuSE Arbitration affects SCO Group's claims for breach of contract and unfair competition, and copyright infringement. Novell also submitted a request for prejudgment interest that the Debtors contend far exceeds what is justified.

4. In an effort to expedite the entry of a final judgment in the Novell Litigation, and after negotiating about methodologies to employ, SCO Group agreed to Novell's calculation of the prejudgment interest as well as the (reduced) calculation of the amounts subject of any potential constructive trust. See Novell's Unopposed Submission Regarding Prejudgment Interest, filed in the Novell Litigation on August 29, 2008, attached hereto as Exhibit B. Further, SCO Group has decided to dismiss its claims for breach of contract and unfair competition, and copyright infringement subject of the SuSE Arbitration. At this point, Novell has no reason to delay any further the submission of a final judgment as directed by the Utah District Court in the July 2008 Ruling. Therefore, the Debtors believe that their request for extension of the exclusive periods would remain within the statutory limitations imposed in the Bankruptcy Code. 11 U.S.C. § 1121(d). In all events, the Debtors' stipulate that the extensions sought in the Motion will terminate when the statute requires. SCO Group today filed a motion with the Utah District Court seeking the entry of a final judgment. (See Exhibit A attached hereto.)

5. As the Debtors also indicated in the Motion, based upon feedback received from prospective interested parties, the entry of a final judgment (and the commencement of the appellate process) in the Novell Litigation will greatly facilitate the Debtors' ability to sell, finance or recapitalize as necessary as a basis for a plan of reorganization. Novell does not think it is credible that a potential investor would find any comfort in an appeal. However, it has been repeatedly expressed to the Debtors by potential investors and potential transaction partners that the entry of a final judgment and the commencement of the appellate process is a significant factor affecting their willingness to go forward. Further, as the Motion points out, it is not the appeal *per se* that would provide comfort, but the establishment of a timeframe on an ultimate resolution of the intellectual property rights issues that will greatly assist with the formulation of investors' assumptions and projections. Likewise, the appeal process and the timing of it are of great concern to SCO Group's customers and potential customers of both its UNIX business and nascent mobility business. This Court has acknowledged that the resolution of the rights between Novell and the Debtors, which won't be finally resolved short of an appeal, is a troubling issue for all parties in these cases. Novell seems to argue to this Court that those issues are trivial while at the same time it is doing all it can in the Utah District Court to block SCO Group from ever getting those issues heard by an appellate court. See Novell's Submission Regarding Entry of Final Judgment, filed in the Novell Litigation on August 29, 2008, attached hereto as Exhibit C.

6. Novell claims that it "begs credulity" for SCO Group to claim that the commencement of an appeal of the court's rulings in the Novell litigation has any impact on the timing of or SCO's ability to present a confirmable plan. However, this Court was correct in its observation that the resolution of the issues remaining in the Novell Litigation are troubling

issues that continue to complicate these cases. *See* Memorandum Opinion (D.E. No. 232), pp. 10 – 11). SCO Group acknowledges that it will not be able to resolve all issues and contingencies before it must confirm a plan of reorganization. However, SCO Group believes that an important issue for investors, customers and partners is when SCO will be able to take an appeal of the August 2007 Ruling and the July 2008 Ruling, and how long will Novell succeed in its continuing attempts to frustrate that appellate review.

7. That timing is a very real concern for Debtors and their stakeholders and will inform the decisions potential investors and customers make in connection with doing business with the Debtors. If it takes months or longer to get a notice of appeal filed, that may have negative impacts on the Debtors' access to capital markets. The Debtors believe that it is important to show creditors, shareholders, potential investors, customers and business partners that an appeal is imminent and that those issues will likely be finally resolved sometime within the usual appellate timeline. A final judgment and notice of appeal is critical to this process and Novell is using legal tactics to delay that from happening.

8. Novell is correct that many issues in the Novell litigation have been resolved—at least at the district court level. Most of these critical issues will not be finally resolved until the appellate court has addressed the issues. The closer the Debtors can get to that date prior to filing a reorganization plan the better able it will be to file a viable plan that meets the objectives of making creditors and shareholders whole. Novell should support those efforts, not try to thwart them.

9. It is true that these cases have seen starts and stops on the part of the Debtors. This is true, at least in part because at the time of the filing, Novell asserted in the Utah District Court that SCO Group owed it nearly \$30,000,000 plus interest and was attempting to have a

constructive trust imposed. Additionally, Novell argued to this Court that SCO owed SuSE up to \$100,000,000 in damages. Novell then waived that claim in an effort to have the automatic stay lifted as to the SuSE Arbitration proceedings.

10. Shortly after these cases were filed, York Capital said that it could do a UNIX deal even with uncertainty resulting from the August 2007 Ruling and the parties worked hard to try to get a transaction completed. However, Novell and IBM objected to the transaction and the Court expressed concerns about how any deal could be done given the issues raised by the August 2007 Ruling. Thereafter, the negotiations around the transaction with York unraveled and ultimately, the transaction was terminated.

11. Not too long after terminating the transaction with York, the Debtors and Stephen Norris Capital Partners agreed to terms that formed the basis of the Debtors' original Plan, that solved for the issues raised by the Novell Litigation. That value of that transaction was in the range of \$75 million to \$100 million. During SNCP's due diligence process, the financial markets began to significantly tighten and investors in general became more nervous about doing deals. The Debtors worked hard to convince SNCP and other potential investors that the August 2007 Ruling and July 2008 Ruling included rulings that: (i) SCO Group had some ownership rights, including all post-1995 copyrights, which is what UnixWare is based on, (ii) Novell had no ownership interest in Openserver, which is the source of most of the Debtors' revenue, and (iii) the Utah district judge did not hold that Novell gets any of SCO Group's new UnixWare royalties (contrary to what one of the articles had asserted). The Debtors learned that they would be completing trial in the Novell Litigation in late April – early May 2008, and based upon the proximity to the trial date, SNCP indicated it wanted to await the results of trial and see the commencement of appellate proceedings before completing a transaction with the Debtors.

12. Prior to the commencement of the trial, Novell reduced its claim by approximately 50% and made concessions that the Debtors believed would further reduce their damage calculation and help the Debtors clear up their rights – and the Debtors were right.

13. In July 2008 the Utah District Court issued the July 2008 Ruling, which found that Novell is not entitled to the Debtors' SCOSource revenue or revenue derived from the Debtors' large license to Microsoft. Novell was awarded approximately \$2.5 million in damages based only upon an amendment of an agreement with Sun Microsystems. The Utah District Court affirmed that SCO Group owns and has full rights to its UnixWare business, has some ownership rights of UNIX and owns all post-1995 UNIX copyrights. The Debtors were told that the July 2008 Ruling cleared up many issues for customers and investors, but not all – they still want to know when the Debtors could appeal.

14. Therefore, the Debtors submit that the timing of beginning the appeal remains an important issue in the minds of investors. Since the Petition Date, the investment climate has continued to worsen and a couple of options have gone away. Despite the declining economic climate, Messrs. Norris and Robbins continue to work with the Debtors to pursue a transaction. They scheduled meetings with investors in London and Paris and Mr. Norris is heading to the Middle East this week. The uncertainty around the Novell Litigation issues and the timing of an appeal are discussed in every meeting. While investors have a favorable view of the July 2008 Ruling, they still want to know when the appellate process will begin and the timing of getting all of the issues resolved.

15. Further, even though the July 2008 Ruling directed Novell to file a proposed final judgment in 10 days and for the parties to enter into stipulations regarding the disposition of certain causes of action, Novell has failed to do so in the two months since the issuance of the

July 2008 Ruling. The Utah District Court also directed Novell to submit interest calculations to the court. SCO Group has agreed to Novell's interest calculation, their constructive trust number (based on information SCO voluntarily provided to Novell) and has agreed to dismiss all remaining causes of action in order to facilitate the entry of the final judgment. Nevertheless, Novell has refused to submit the form of final judgment as directed by the Utah district court. Now, knowing full well that an appeal of the Novell Litigation rulings is important to the Debtors' reorganization efforts, they object to the extension of the Debtors' exclusive periods.

16. In the meantime, the Debtors' mobility business has blossomed. For example, Franklin Covey, has recently launched "FC mobilelife™" which uses mobile applications licensed to it from the Debtors (through Me, Inc.). The Debtors believe that the buzz and feedback surrounding the mobile applications enhance the possibilities of a transaction.

17. Novell cites *In re R.G. Pharmacy, Inc.*, 374 B.R. 484 (Bankr. D. Conn. 2007) for the proposition that unresolved litigation, even if important, is not a ground for extension of exclusivity. It is true that the court in that case held that the "fact that litigation is pending with creditors is not itself sufficient cause to justify an extension of the exclusivity period..." *R.G. Pharmacy*, 374 B.R. at 484 (quoting *In re Southwest Oil Co. of Jourdanton, Inc.*, 84 B.R. 448, 452 (Bankr. W.D. Tex. 1987)). However, the court also found that the debtor did not show that the requested extension was likely significantly to improve the progress of the case given the breakdown of negotiations with its largest creditors. *Id.*

18. Here, the Debtors are not premising their request solely on the pendency of the Novell Litigation. The Debtors have been advised by potential investors or transaction partners that the commencement of the appellate process regarding the August 2007 Ruling and the July

2008 Ruling will facilitate the Debtors' ability to sell, finance or recapitalize around the UNIX business.

19. The Debtors disagree with Novell's mischaracterizations and analysis of the factors in determining "cause" as applied to the facts and circumstances of these cases. Apparently Novell has forgotten that the Debtors have negotiated and resolved significant issues with Novell! Further, since SCO Group has agreed to dismiss the claims subject of the SuSE Arbitration, Novell can hardly state that the Debtors are pressuring Novell or trying to avoid the SuSE Arbitration. While structuring a plan in itself may not be complicated, the reorganization plan that the Debtors believe would be in the best interests of all constituencies, including equity, includes a transaction partner and the Debtors do not know at this point whether the transaction will take the form of an equity investment, financing, recapitalization or something else. In addition, even an uncomplicated transaction takes some time to draft – Novell knows this.

20. The Debtors have also negotiated for a resolution of the largest claim against the estate – the claim of the IPO plaintiffs. Claims review has begun in preparation for the eventual filing of an amended or new plan and estimation of certain contingent or unliquidated claims may soon be sought.

21. Finally, the Debtors are not seeking an open-ended extension. The Debtors recognize that any extension granted by the Court must be within the confines of the statutory mandates of the Bankruptcy Code and cannot go beyond March 16, 2009 and May 14, 2009, respectively.

22. The Debtors submit that cause exists to extend the exclusive periods, subject to the statutory limitations imposed by the Bankruptcy Code. The Debtors are working toward a transaction that will allow it to pay creditors in full, allow equity to retain their interests, allow

mandates of the Bankruptcy Code and cannot go beyond March 16, 2009 and May 14, 2009, respectively.

22. The Debtors submit that cause exists to extend the exclusive periods, subject to the statutory limitations imposed by the Bankruptcy Code. The Debtors are working toward a transaction that will allow it to pay creditors in full, allow equity to retain their interests, allow employees to keep their jobs and allow the Debtors to continue their businesses so that they can continue to provide their numerous valued customers goods and services that enhance and help keep those businesses running smoothly. The Debtors prefer to propose a plan based upon an actual transaction, and file a disclosure statement containing executed transaction documents, rather than a plan that provides for contingencies without a transaction partner. The Debtors are current on all of their post-petition obligations and do not believe the requested extension will prejudice any party in interest.

WHEREFORE, the Debtors request that the Court enter an order granting the Motion and extending the Debtors' exclusivity periods as requested therein, subject to the statutory limitations imposed by the Bankruptcy Code, and granting them whatever other and further relief the Court deems just and appropriate.

Dated: September 15, 2008

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