

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

The SCO GROUP, INC., et al.,

Debtors.

Chapter 11

Case No. 07-11337 (KG)
(Jointly Administered)

Hearing Date: February 25, 2009 at 11:00 a.m.
prevailing Eastern Time

Objection Deadline: February 18, 2009 at 4:00 p.m.
prevailing Eastern Time

Related Docket Nos. : 655, 662, 694

**OBJECTION OF INTERNATIONAL BUSINESS MACHINES CORPORATION
TO DEBTORS' MOTION TO APPROVE DISCLOSURE STATEMENT**

International Business Machines Corporation ("IBM"), a creditor and equity security holder in these Chapter 11 cases, objects to the "Debtors' Revised Motion for an Order (I) Scheduling Confirmation Hearing; (II) Approving Form and Contents of Solicitation Package; (III) Approving Form and Manner of Notice of Confirmation Hearing; (IV) Establishing Record Date and Approving Procedures for Distribution of Solicitation Packages; (V) Approving Forms of Ballot; (VI) Establishing Voting Deadline for Receipt of Ballots; (VII) Approving Procedures for Vote Tabulations; (VIII) Establishing Deadline and Procedures for Filing Objections to Confirmation of the Plan; and (IX) Granting Related Relief", filed with this Court by the debtors and debtors in possession, The SCO Group, Inc. ("SCO Group") and SCO Operations, Inc. ("Operations", and, collectively with SCO Group, "SCO" or the "Debtors"), on February 4, 2009 (the "Motion") seeking, among other things,

approval of the Disclosure Statement filed January 8, 2009 (the “Disclosure Statement”) [Docket No. 655].

Preliminary Statement¹

1. The Motion seeks approval of a Disclosure Statement for the Debtors’ Amended Joint Plan of Reorganization, filed January 8, 2009 (the “Amended Plan”) [Docket No. 654], that lacks substantial and necessary information: (1) an accurate and adequate summary of the Amended Plan and sufficient information describing its proposed execution; (2) adequate information about reorganized SCO’s business plan as a going-concern; (3) adequate information about financial projections; (4) adequate information about certain pending intellectual property litigation; (5) a complete and accurate description and valuation of the Debtors’ assets and sufficient detail with respect to the condition of the Debtors during the pendency of these Chapter 11 cases; (6) any information regarding the potential business risks posed if reorganized SCO proceeds under the Amended Plan; and (7) adequate information with respect to the potential Federal tax consequences under the Amended Plan.

2. Because all of this information is required to enable creditors and equity security holders to make an informed judgment about whether to accept or reject the Amended Plan, the Disclosure Statement does not meet the requirements of section 1125 that a disclosure statement contain “adequate information”. For these reasons, as explained more fully below, this Court should deny the Motion.

¹ References to the Disclosure Statement, filed January 8, 2009, are given as “D.S. at ____.”

Background Facts

A. SCO's Litigation against IBM and Novell

3. In early 2003, SCO attempted to profit from the increasing popularity of the Linux operating system by, among other things, embarking on a far-reaching publicity campaign to create the false and unsubstantiated impression that SCO had rights to the Linux operating system that it does not have and by bringing baseless legal claims against IBM, Novell, Inc. ("Novell") and others.

4. SCO sued both IBM and Novell in separate actions in Utah, where SCO has its principal place of business (such cases respectively, the "IBM Case" and the "Novell Case"). In response, IBM and Novell asserted several counterclaims against SCO. The parties have been litigating separate cases in Utah before the same U.S. District Judge (Dale A. Kimball) and the same U.S. Magistrate Judge (Brooke C. Wells) (the "Utah Court") for more than five years.

5. SCO's cases against IBM and Novell concern a host of complex intellectual property and other issues relating to SCO's UNIX business, including, but not limited to: who owns the copyrights to the UNIX operating system; whether SCO has the right to control hundreds of millions of lines of computer source code created and owned by IBM; whether SCO has the right to foreclose the use by others of the publicly-available Linux operating system, which includes hundreds of thousands of lines of IBM copyrighted code; and whether IBM has a perpetual and irrevocable license relating to UNIX.

6. In a series of decisions, the Utah Court called into question the veracity of SCO's statements about its claims and rights and, at least in the IBM Case, materially limited SCO's case. More importantly, the Utah court entered an order in the Novell Case, rejecting two keystones of SCO's litigation campaign. The court ruled that

Novell, not SCO, owns the core UNIX copyrights and that Novell has the right, which it has exercised on IBM's behalf, to waive SCO's purported claims against IBM (the "Novell Summary Judgment Ruling"). Although this Chapter 11 case stayed further proceedings in that litigation, following a motion filed by Novell to lift the automatic stay and permit the trial to proceed, this Court modified the stay to permit Novell to pursue the Novell Case except with respect to determination of the imposition of a constructive trust, an issue over which this Court has retained jurisdiction (see Memorandum Opinion (filed herein November 27, 2007); Order Granting Novell's Motion for Relief From the Automatic Stay to Proceed with the Lawsuit (filed herein November 27, 2007)) [Docket Nos. 232, 233]. On November 20, 2008, a Final Judgment was entered in the Novell Case and on November 25, 2008, SCO filed a notice of appeal.

7. While the Utah Court has not yet ruled on IBM's summary judgment motions (which concern all of SCO's claims), that court has stated that the Novell Summary Judgment Ruling "significantly impacts" the IBM Case. The parties disagree as to the full effect of the Novell decision on the IBM Case, but SCO concedes that the ruling forecloses six of SCO's nine claims against IBM. SCO filed its petition for relief under the Bankruptcy Code on the eve of the trial to determine SCO's damages to Novell—shortly before the Utah Court was expected to rule on the pending motions.

8. The Utah litigations' cost, coupled with declining revenues, led SCO to file this Chapter 11 case on September 14, 2007.

B. SCO's Amended Plan and Disclosure Statement

9. SCO filed the Disclosure Statement and the Amended Plan with the Court on January 8, 2009, and the Motion on February 4, 2009.

10. The Disclosure Statement summarizes the Amended Plan as follows:

“(i) sale by public auction of the Mobility and OpenServer Businesses, with proceeds of such sale being used to pay Allowed Claims in full on the Effective Date; and/or in addition, if the sale does not generate an amount deemed sufficient by the Debtors, in their sole discretion, to pay all Allowed Claims other than the Allowed Claims subject of the Pending Litigation in full on the Effective Date, (ii) the Debtors will pursue a go-forward business model of, among other things: (a) launching two products; (b) implementing an improved pricing and discount strategy; (c) continuing a ‘true-up’ licensing program; (d) working with customers to deliver feature enhancements to customers through a non-recurring engineering revenue model; and (e) reducing operating expenses by approximately 20-30% (comparing FY 2008 with projected operating expenses for FY 2009[)].”

(D.S. at 21 (emphasis added); Amended Plan at 11.)

11. The Amended Plan contemplates, among other things: (1) paying holders of all allowed priority claims and allowed secured claims, which are designated to be in Class 1, Class 1A, Class 2 and Class 2A, 100% of the principal amount of such claims, with interest if applicable, on the Effective Date or as soon thereafter as practicable; (2) paying unsecured claims against SCO other than claims that are the subject of litigation, including the IBM Case and the Novell Case (such litigation, the “Pending Litigation”), which are designated to be in Class 3 and Class 3A, 100% of the principal amount of such claims, with interest if applicable, in either one or two installments (depending on whether the Debtors deem, in their sole discretion, the proceeds of the sale by auction of the Mobility and OpenServer Businesses (the “Asset Sale”) sufficient to pay such claims in full), with the

first distribution to occur on the later of the date the Amended Plan becomes effective (the “Effective Date”) or the date each such claim becomes an allowed claim and the second distribution, if applicable, to occur on October 31 of the calendar year following the first distribution or as soon thereafter as practicable; and (3) paying unsecured claims held in respect of Pending Litigation, including IBM’s and Novell’s counterclaims, which are designated to be in Class 4, 100% of the principal amount of such claims, with interest if applicable, in either (i) five equal installments, with the first distribution to occur on the later of the Effective Date or the date such claim becomes an allowed claim and four annual distributions to occur on October 31 of each calendar year following the first distribution or as soon thereafter as practicable or (ii) if the allowed claim exceeds an amount that the reorganized Debtors can pay in full with interest over five years following the date such claim becomes allowed, new shares of reorganized SCO Group which will be interpled to this Court and cancellation of all of SCO Group’s existing shares. The existing common equity interests in SCO Group, which are designated to be in Class 5, are to remain unaffected except to the extent the treatment of the Class 4 claims may trigger the extinguishment and cancellation of such common equity interests. The existing common equity interests in Operations, which are in Class 5A, are to remain unaffected and be retained by reorganized SCO Group. (See D.S. at 25-29; Amended Plan at 8-11.)

12. The Amended Plan also provides that as of the Effective Date the reorganized Debtors will modify their 2004 Omnibus Stock Incentive Plan and the terms of options issued thereunder, (a) to reduce the exercise prices of outstanding stock options to a price equal to \$0.02 per share above the fair market value of the common stock of SCO

Group on the Effective Date, and (b) to extend the period in which the outstanding stock options may be exercised for up to 18 months. (*Id.* at 29; 11.)

* * *

13. IBM objects to the Motion on the ground that the Disclosure Statement as currently written lacks adequate information about the Amended Plan, as required by section 1125(b) of the Bankruptcy Code.

Argument

I. THE MOTION SHOULD BE DENIED BECAUSE THE DISCLOSURE STATEMENT LACKS ADEQUATE INFORMATION

A. A Disclosure Statement Must Contain “Adequate Information”

14. Section 1125(b) of the Bankruptcy Code prohibits SCO from soliciting acceptances of the Amended Plan until this Court approves the Disclosure Statement as containing “adequate information”. Section 1125(a) defines “adequate information” as:

“information 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, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interest in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan. . . .” 11 U.S.C. § 1125(a)(1).

The express statutory obligation to provide adequate information in a disclosure statement is a “pivotal concept in reorganization procedure under the Code”. Oneida Motor Freight, Inc. v. United Jersey Bank, 848 F.2d 414, 417 (3d Cir. 1988); see also Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. General Motors Corp., 337 F.3d 314, 322 (3d Cir. 2003) (“The importance of full disclosure is underlaid by the reliance placed upon the disclosure

statement by the creditors and the court. Given this reliance, we cannot overemphasize the debtor's obligation to provide sufficient data to satisfy the Code standard of adequate information.") (quotations and citations omitted); Ryan Operations G.P. v. Santiam-Midwest Lumber Co., 81 F.3d 355, 358 (3d Cir. 1996) ("Because creditors and the bankruptcy court rely heavily on the debtor's disclosure statement in determining whether to approve a proposed reorganization plan, the importance of full and honest disclosure cannot be overstated.") (citations omitted).

15. To satisfy section 1125(a)'s standard, a disclosure statement must contain, "at a minimum", adequate information concerning "all those factors presently known to the plan proponent that bear upon the success or failure of the proposals contained in the plan." In re Beltrami Enters., 191 B.R. 303, 304 (Bankr. D. Pa. 1995) (quotations and citations omitted); see also In re Ligon, 50 B.R. 127, 130 (Bankr. D. Tenn. 1985); In re Stanley Hotel, Inc., 13 B.R. 926, 929 (Bankr. D. Colo. 1981). "Conclusory allegations or opinions without supporting facts" concerning these factors "are generally not acceptable". In re Beltrami Enters., 191 B.R. 303, 304 (Bankr. D. Pa. 1995) (citations omitted).

16. These factors include, among others: a summary of the plan of reorganization and information as to how the plan is to be executed; a description of the reorganized debtor's business; projections of future operations that would be relevant to creditors' and equity security holders' determinations of whether to accept or reject the plan; information regarding current litigation against the debtor or litigation likely to arise in a non-bankruptcy context; an accurate description of the debtor's available assets and their value; the condition and performance of the debtor while in Chapter 11; information relevant to the risks posed to creditors and equity security holders under the plan; and the tax

consequences of the plan. See In re Microwave Products of America, Inc., 100 B.R. 376, 378 (Bankr. D. Tenn. 1989); In re Scioto Valley Mortg. Co., 88 B.R. 168, 170 (Bankr. D. Ohio 1988).

17. SCO fails to satisfy the statutory standards of disclosure as required under section 1125(a) of the Bankruptcy Code because its Disclosure Statement lacks (1) an accurate and adequate summary of the Amended Plan and sufficient information describing its proposed execution; (2) adequate information about reorganized SCO's business plan as a going-concern; (3) adequate information about financial projections; (4) adequate information about the Pending Litigation; (5) a complete and accurate description and valuation of the Debtors' assets and sufficient detail with respect to the condition of the Debtors during the pendency of these Chapter 11 cases; (6) any information regarding the potential business risks posed if the reorganized Debtors proceed under the Amended Plan; or (7) adequate information with respect to the potential Federal tax consequences under the Amended Plan. Although the description of the Disclosure Statement's deficiencies below identify many of the numerous questions that the Disclosure Statement raises but does not answer, the list of questions cannot address all of the deficiencies and is not intended to be limiting. IBM therefore reserves its right to review and object to the revised Disclosure Statement once SCO provides additional information and parties in interest have a more complete proposed Disclosure Statement as a proper starting point for review and analysis.

B. The Disclosure Statement Does Not Contain Adequate Information

1. The Disclosure Statement Lacks an Accurate or Adequate Summary of the Amended Plan and Sufficient Information Describing its Proposed Execution

18. A disclosure statement must provide "adequate information", which must be accurate and free from substantial deficiencies, regarding the terms of the Chapter 11

plan and the means of its implementation, especially where, as here, the Amended Plan contemplates continuing deferred payment obligations and the possible issuance of equity securities.

19. The Disclosure Statement's shortcomings are evident even in its first sentence, which provides, in relevant part, that "the [Debtors] ... provide this [Disclosure Statement] to the Holders of Claims against SCO Group classified in Classes 3, 3A and 4 and to the shareholders of SCO Group (Class 5) in order to permit such creditors and shareholders to make an informed decision in voting to accept or reject the [Amended Plan]." (D.S. at 1.) While the average reader might realize that the reference to "Holders of Claims against SCO Group" should properly refer to Holders of Claims against the Debtors (which would include Operations), the Disclosure Statement contains many similar deficiencies (numerous references to the undefined entity "SCO" (See D.S. at, inter alia, 5-8,10,11); incorrect statements that the Debtors' various products and services are delivered by SCO Group rather than by Operations (See D.S. at 4-10); etc.) that collectively result in a Disclosure Statement that, judged on the basis of such deficiencies alone, is at times slipshod and careless and, all too often, winds up misleading and inadequate.

- The Disclosure Statement should be revised to identify properly and accurately the Debtor entities to which it refers.

20. This lack of precision and carelessness permeates the Disclosure Statement, including when the Debtors attempt to summarize the terms of the Amended Plan:

"...the [Amended] Plan provides for the following: (i) sale by public auction of the Mobility and OpenServer businesses, with proceeds of such sale being used to pay Allowed Claims in full on the Effective Date; and/or in addition, if the sale does not generate an amount deemed sufficient by the Debtors, in their sole discretion, to pay all Allowed Claims other than the

Allowed Claims subject of the Pending Litigation in full on the Effective Date, (ii) the Debtors will pursue a go-forward business model of, among other things: (a) launching two products; (b) implementing an improved pricing and discount strategy; (c) continuing a ‘true-up’ licensing program; (d) working with customers to deliver feature enhancements to customers through a non-recurring engineering revenue model; and (e) reducing operating expenses by approximately 20-30% (comparing FY 2008 with projected operating expenses for FY 2009[]].”

(Id. at 21.) Read literally, this suggests that whether the “go-forward business model” described in clause (ii) of the above summary of the Amended Plan would ever be implemented is subject to the Debtors’ determination, in their sole discretion, that the Asset Sale proceeds are not sufficient “to pay all Allowed Claims other than the Allowed Claims subject of the Pending Litigation”. That is, if the Debtors decide that the Asset Sale has generated enough revenue to pay all Allowed Claims other than the Allowed Claims subject of the Pending Litigation, the Amended Plan would not include the “go-forward business model” of clause (ii) at all, implying, as certainly cannot be the case, that in such circumstances the reorganized Debtors would have no further obligations under the Amended Plan following the Asset Sale and that the “go-forward business model” of clause (ii) would be rendered a nullity.

- The Plan summary and description should clarify the relationship between the Asset Sale and the go-forward business model, providing information, among other things, as to what factors would cause the Debtors to adopt one avenue or the other.

21. Additionally, clause (ii)’s “go-forward business model” contemplates two product launches, one of which we are informed will be the core product of the Debtors’ mobile business—a cloud server-based product (known as “SCO Cloud Server”). Indeed, it

repeatedly stresses SCO Cloud Server's importance to reorganized SCO's future, with proclamations including, "Just as SCO UNIX has been the backbone for thousands of customers over the last 30 years, the SCO Cloud Server platform strategy is designed to become the foundation of the reorganized SCO for the next 30 years." (D.S. at 24.)

However, without any further explanation, SCO Cloud Server is also included in the Asset Sale as part of the Mobility business for only \$1,000,000, hardly an amount that reflects SCO Cloud Server's supposed centrality not only to the reorganized Debtors' business but to the industry as a whole. (Id. at 22)

- The Disclosure Statement should clarify the role of each of the Debtors' businesses and products, including SCO Cloud Server, in the go-forward business model and in the Asset Sale, with explanations as to the Debtors' reasoning for its choices and valuations.

22. Turning to the Asset Sale in particular, the Disclosure Statement does not provide adequate information regarding how and when the Asset Sale is to be conducted.

- The Disclosure Statement should be updated to describe the order, if any, that the Court grants on the Debtors' Motion, filed February 5, 2009, to approve asset sale procedures.

23. The Disclosure Statement provides only a list of suggested minimum bids for each component business proposed to be sold, without ever suggesting how the Debtors picked the minimum bids. (See D.S. at 21-22.) Simply listing each component business's trade name alongside a suggested minimum bid is not "adequate information". Creditors and equity security holders are not able to make an informed judgment about

whether to accept or reject the Amended Plan, as section 1125 requires, without basic, standard information, including:

- The portion of the current workforce, division by division, location by location, that the Debtors expect to go with the sale of each component business²;
- The portion of the Debtors' current total revenues that each of these component businesses account for³; and
- The manner in which proceeds of any successful Asset Sale are to be allocated between paying claims and any alternative uses, including in business operations or for payment of the Allowed Claims subject of the Pending Litigation.⁴

24. The Disclosure Statement must clearly and succinctly inform the creditors and equity security holders what they are going to get, when they are going to get it, and what contingencies there are to getting it. The Disclosure Statement fails to provide sufficient clarity with respect to treatment of Allowed Claims subject of the Pending Litigation. Class 4's creditors are informed that there are two payment alternatives: the first

² This is especially significant given that, as discussed *infra* at ¶44, the Disclosure Statement states that there is a total of only 66 employees employed by the Debtors "and their foreign subsidiaries and affiliates." (D.S. at 3).

³ The projections provided with respect to the go-forward business model in the D.S. at 40-43 suggest that the revenue estimated to be generated by the "Mobility" portion of the Mobility and OpenServer Businesses in the first quarter of 2009 is zero and that the revenue expected to be generated by the "OpenServer" portion of the Mobility and OpenServer Businesses to be sold is not separately disclosed. Instead the "OpenServer" estimated revenues are indivisibly pooled together with the Legacy UnixWare estimated revenues and are, in the aggregate, expected to decline. In neither case are separate current revenue figures provided.

⁴ The Disclosure Statement touches this issue only briefly when it states that the payment of general unsecured claims (other than Allowed Claims subject of the Pending Litigation) shall be either in one installment or two installments, depending on whether "the proceeds of the Asset Sale(s) are insufficient, in the Debtors' business judgment, to fully pay the Allowed Claims" (*See* D.S. at 27, 28). No information is provided about what will inform "business judgment".

contemplates payment of the claims (plus applicable interest) in cash in five equal annual installments; the second, which is triggered presumably at the discretion of the Debtors, contemplates that reorganized SCO “will cancel its existing shares and issue new shares which will be interpled to [this Court] for the benefit of those holders of [allowed claims subject of the Pending Litigation].” (D.S. at 28; Amended Plan at 10.) The Disclosure Statement provides no additional information. Accordingly, the holders of Allowed Claims subject of the Pending Litigation are not informed of what they should expect to receive under the Amended Plan and when they may expect to receive it.

- The Disclosure Statement should describe when, how and on what basis the payment alternative determination is to be made.
- The Disclosure Statement should describe the details of the corporate or legal mechanisms by which “existing shares” of reorganized SCO Group may be cancelled and new shares then issued and interpled to this Court for distribution in payment of the claims.

2. The Disclosure Statement Lacks Adequate Information About Reorganized SCO’s Business Plan as a Going-Concern

25. The Disclosure Statement should provide an understandable and sufficiently detailed description of reorganized SCO’s business plan as a going-concern that adequately discloses information that would be necessary for creditors and equity security holders to judge the likelihood of success of the business plan. Such disclosure is particularly important here, where the Amended Plan provides for the treatment of certain claims and interests not funded by Asset Sale proceeds to be paid by the reorganized Debtors. Such treatment may include, for Allowed Claims subject of the Pending Litigation, deferred

payments over five years after the Effective Date or, alternatively, issuance of common stock in SCO Group.

26. The need for “adequate information” about reorganized SCO’s go-forward business model is especially acute because the Amended Plan does not seem even to address any of the factors that drove SCO into bankruptcy. SCO filed for Chapter 11 because of, among other things, a significant “decline in revenue” in UNIX-based products and services over the past several years due to increased competition. (D.S. at 10-11.) The Disclosure Statement does not suggest that this problem has gone away and simply offers up an Asset Sale that would involve selling all or some portion of the Mobility and OpenServer Businesses, which appear to include every single viable non-UNIX business the Debtors own. In effect, the Disclosure Statement informs creditors and equity security holders that if the Asset Sale is consummated, the result would divest SCO of its entire mobile business, the very same mobile business that the Debtors devote numerous Disclosure Statement pages to describing as representative of the next-generation of the reorganized Debtors’ products and services; the very same mobile business that the Debtors adorn with expectations of explosive growth in emerging markets and the very same mobile business for which the Disclosure Statements makes inflated promises, including, notably, the SCO Cloud Server initiative, which “is designed to become the foundation of the reorganized SCO [sic] for the next 30 years.” (D.S. at 24; See also, Id. at 6-9, 22-24 (for various descriptions of the Debtors’ mobile products and services).) Yet the Disclosure Statement provides only vague, general statements about the remaining UNIX-based business.

- The Disclosure Statement should provide specific information on how the Debtors plan to fix their still unresolved business issues on UNIX-based products and services that would remain after the Asset Sale.

27. Because the Amended Plan contemplates continuing deferred payment obligations and the possible issuance of equity securities, sufficient disclosure for go-forward operations, products and services of the reorganized Debtors are paramount to its creditors' and equity security holders' ability to judge the likelihood of success of reorganized SCO's business plan, especially how the go-forward business model could reasonably be expected to achieve the results projected by the Debtors. Instead of specifics, the Disclosure Statement provides vague promises and "plans" for the future:

While SCO Group has a long history of providing customers virtualization products, it plans to offer a new service where customers, particularly legacy customers, gain access to the technology they need to run their applications in a virtual environment.

SCO Group plans to continue to focus its UNIX development resources on current UNIX products and plans to support requirements for modern hardware and applications software. In addition, SCO Group intends to focus other engineering, research and development resources on mobility products and services for personal and professional productivity. The Debtors expect that these mobility products and services will enable easy, secure, real-time mobile access to all kinds of information stored in enterprise and web-based systems without the need for direct connection between end-point devices and those systems.

(D.S. at 5 (emphasis added).)

- The Disclosure Statement should provide specific details about new products and services, including how much has already been invested to develop these products and services; the cost of the UNIX development resources the Debtors intend allocate to current UNIX products; the

current stage of development and anticipated time of market entry; sales and marketing information; and estimated annual revenue.

28. The Disclosure Statement further provides, “SCO [sic] will introduce annual maintenance subscriptions for its SCO UNIX offerings that will include maintenance updates and value-added technology ...”. (D.S. at 6, emphasis added) and, in describing the rising use of mobile technology in emerging markets, “SCO [sic] will continue to deliver and innovate mobile solutions to best exploit the growth in these markets” (D.S. at 7, emphasis added). While the Disclosure Statement is replete with similarly enticing promises of initiatives and new products and services that always seem to be just around the next corner, the details of such plans are obscure or missing. Such statements serve only to create more questions than they purport to answer and cannot be deemed “adequate information” such that the Debtors’ creditors and equity security holders may properly evaluate the Amended Plan.

- The Disclosure Statement should describe, among other things, how much additional revenue the Debtors expect to raise from such annual subscriptions and how much the subscriptions will cost to implement.
- The Disclosure Statement should describe specifically, among other things, how the Debtors intend to exploit growth in emerging markets, whether that will require added sales and marketing personnel, how much the Debtors expect to spend to take advantage of the opportunities in the emerging markets and whether the analysis changes if the Asset Sale is consummated in whole or in part and some or all of the mobile

products and services of the Debtors are transferred to a third-party purchaser.

3. The Disclosure Statement Lacks Adequate Information About Financial Projections⁵

29. A disclosure statement must provide adequate disclosure of financial projections, especially here, where the Amended Plan contemplates continuing deferred payment obligations and the possible issuance of equity securities. Disclosure with respect to financial projections prepared on a reasonable basis in good faith and not replete with inconsistencies is necessary to allow creditors and equity security holders to assess the risks that the reorganized Debtors might not be able to meet the Amended Plan's payment provisions and the risks to the Debtors' earning capacity and financial viability. Otherwise the financial projections would be little more than glowing opinions having little or no basis in fact.

30. The Disclosure Statement summarizes the past, present and future of UNIX-based application platforms:

If one were to think about the landscape of UNIX-based application platforms, SCO [sic] would be the clear leader in the first wave with 43% market share in the 1990's. The second wave would see Linux at the forefront being led by IBM. SCO [sic] has been building the requisite technologies and is now going to market with the goal of becoming the leader of the third wave of business application platforms with its SCO Cloud Server and [virtualization technology called "SCO UNIX Virtual")] products.

(D.S. at 24.) The statement about the first wave is questionable at best, and there is no supporting evidence or explanation. The statement about the second wave is similarly

⁵ References to any fiscal year of SCO are given as "FY ____" and references to any fiscal quarter of SCO are given as "Q_ - ____", in each case in conformity with usage in the Disclosure Statement.

without supporting evidence and worse, is either misleading, inaccurate or both. Most troubling, however, is whether the final sentence's assertion that SCO "is now going to market with the goal of becoming the leader of the third wave of business application platforms with its SCO Cloud Server and SCO UNIX Virtualization products ..." can be justified at all or whether it is so unsupported and self-serving that it tests the limits of good faith. The absence of concrete factual support for the statement could render it misleading, as this claim is made despite the disclosures that there is a total of only 66 employees employed by the Debtors "and their foreign subsidiaries and affiliates ..." (D.S. at 3); that SCO incurred only "\$3,684,000 in research and development expense during the fiscal year ending October 31, 2008 ..." (D.S. at 9); that the minimum bid the Debtors propose to accept for their entire mobility business is only \$2,000,000 and that the SCO UNIX Virtual line of products and services have not yet been released. (See D.S. at 21.)

- The Disclosure Statement should support or eliminate the questionable statement about SCO's role in the "first wave" of UNIX-based platforms.
- The Disclosure Statement should support or eliminate the misleading or incorrect statement about the so-called "second wave", about IBM, about the phrase "UNIX-based application platform" and about the relationship implied between UNIX and Linux.
- The Disclosure Statement should reconcile the facts presented in the Disclosure Statement with the claim that SCO will become "the leader of the third wave of business application platforms".

31. The descriptions of the assumptions for projected revenue growth attributable to the Debtors' primary UNIX-based products "UnixWare" and "OpenServer", say that "revenue projections for the traditional UnixWare and OpenServer products are estimated to decline at 20% rate ...". However, the accompanying table of projected revenues for UnixWare and OpenServer products shows an increase in estimated revenue from Q1-2009 to Q2-2009 and no decrease in estimated revenue between Q2-2009 and Q3-2009 or between Q3-2009 and Q4-2009.

- The Disclosure Statement should correct or explain this apparent discrepancy.

32. The assumptions for projected revenue growth attributable to the SCO UNIX Virtual line of products and services are facially deficient and irreconcilable. The Disclosure Statement says that SCO UNIX Virtual will become available in Q3 FY, but fails to include the year. (D.S. at 41.) The description of the assumptions says that "SCO UNIX Virtual projected revenues are \$3.0 million in FY 2009 ..." while the accompanying SCO UNIX Virtual projected revenues table shows projected revenues of \$1,500,000 in FY 2009. (Id. at 41-42.) Finally, the description of the assumptions says that there are "2.5 million UNIX installed servers which include a significant number of active and potential candidates for virtualization"; that "SCO UNIX Virtual is priced at a one-time license upgrade of approximately \$500 per server" and that "SCO UNIX Virtual penetration on servers is projected at 1% in FY 2009 and ramping to 23.5% in FY 2011". (Id. at 41.) Based on the foregoing assumptions (i) the projected revenues for FY 2009 should be calculated as 1% of 2,500,000 servers at \$500 per server, or \$12,500,000 and (ii) the projected combined revenues for FY 2009, FY 2010 and FY 2011 should be calculated as 23.5% of 2,500,000

servers at \$500, or \$293,750,000. Inexplicably, the accompanying chart of projected revenues for SCO UNIX Virtual provides projected revenues of \$1,500,000 in FY 2009, \$13,500,000 in FY 2010 and \$18,000,000 in FY 2011, which results in projected combined revenues for FY 2009, FY 2010 and FY 2011 of \$33,000,000, which is an order of magnitude less.

- The Disclosure Statement should be revised to correct or explain the irreconcilable information in the text and table.

33. Additionally, the descriptions and financial projections of certain of the go-forward business model's elements, not including the as yet unreleased SCO UNIX Virtual line of products and services, often appear to be based on factually unsupported assumptions as to projected revenue growth. While debtors may be entitled to a certain degree of optimism and the view that their operations may improve, the Debtors here cannot reasonably represent that their operations will improve if all historical facts and their own admissions suggest the contrary, including the disclosure that SCO filed for Chapter 11 because of, among other things, a significant "decline in revenue" in UNIX-based products and services over the past several years due to increased competition. (See, D.S. at 10-11.) The Disclosure Statement nowhere suggests that this problem has gone away.

34. The Disclosure Statement provides no financial projections estimating the potential effect on revenue of an improved pricing and discount strategy nor any information as to the time for implementing the strategy. The only business for which the Disclosure Statement provides the pricing change effective date is "FCmobilelife", but any change for FCmobilelife is likely to be inconsequential for reorganized SCO as a going-concern because it is part of the mobility business contemplated to be sold in the Asset Sale.

- The Disclosure Statement should provide the details about implementing the proposed improved pricing and discount strategy, including estimated revenues and implementation timing and the facts underlying the revenue assumptions.

35. The Disclosure Statement says that “SCO [sic] will put a dedicated team on this initiative to true-up license revenue where applicable” but does not provide any information as to the anticipated cost to enforce such a program. (D.S. at 25.) Additionally, the assumptions for projected revenue growth attributable to the true-up license program illustrate a jump in estimated revenue from \$1,500,000 in FY 2009 to \$9,925,000 in FY 2010 (an increase of over 500%) and a jump in estimated revenue from \$9,925,000 in FY 2010 to \$15,138,000 in FY 2011 (an increase of over 50%), in each case, without any factual basis or explanation for the tremendous projected revenue increases.

- The Disclosure Statement should provide additional details about the true-up licensing program and describe the facts that underlie the assumptions on revenue, costs and other financial projections.

36. The Disclosure Statement says:

SCO [sic] will preserve the core engineering and sales teams but will also increase external partnerships with third-party development organizations in the U.S. and around the world to increase its ability to deliver the next-generation UNIX operating system and cloud-based platform solutions. SCO [sic] will leverage the power of the Internet for the distribution of its cloud-based applications through portals such as Apple’s App Store.

(D.S. at 25.) Such information, without more, is inadequate to provide creditors and equity security holders with the ability to make an informed judgment about this element of the Amended Plan.

- The Disclosure Statement should provide further details, including (i) how and at what anticipated cost the Debtors expect to increase external partnerships with third-party development organizations in the U.S. and around the world and (ii) how, specifically, the Debtors intend to “leverage the power of the Internet”. (*Id.* at 25.)

37. The assumptions for projected expense reductions attributable to the Restructured Operations show an annual decrease of over \$4,000,000 in each of FY 2009, FY 2010 and FY 2011, in each case, without any explanation.

- The Disclosure Statement should reconcile such substantial cost reductions in general and administrative expenses with the tremendous revenue increases projected due to the SCO UNIX Virtual line of products and services, the revised pricing model and the true-up license program (which revenue increases would typically require a corresponding increase in general and administrative expenses such as IT infrastructure expenses, corporate office facility expenses telecommunications expenses).

38. Finally, the financial information provided as exhibits to the Disclosure Statement and determined on the basis of the foregoing assumptions, in particular Exhibit 2 (Liquidation Analysis) and Exhibit 3 (Asset Sale Projection), contain deficiencies both in form and in substance.

- Exhibit 2 and Exhibit 3 should be updated to reflect the most current financial information available before the February 25, 2009 hearing date.

- Additionally, the Notes preceding each of Exhibit 2 and Exhibit 3 indicate cash and cash equivalents on hand at October 31, 2008 and restricted cash at October 31, 2008 that are facially inconsistent with the cash amount reported on the Monthly Operating Report for Operations filed for such time period [Docket No. 665] but should be updated in any event to the most recent financial information available before the February 25, 2009 hearing date.

39. With respect to Schedule D of Exhibit 2 in particular, the Disclosure Statement sets forth a wind-down budget which anticipates either a 3-month wind-down period or a 6-month wind-down period for liquidation. In neither case is any information provided to justify the expectation of a delayed wind-down period in connection with a liquidation.

- If there is a specific reason the Debtors anticipate a delayed liquidation, the Disclosure Statement must disclose it.

40. In addition, Exhibit 3 provides an Asset Sale analysis in connection with a confirmed Chapter 11 plan. Schedule B of Exhibit 3 provides the distribution analysis in connection with such an Asset Sale. It includes a calculation of the distribution of reorganized SCO's assets, calculated in the same manner as one would conduct a liquidation analysis, which is inexplicable where the assets of reorganized SCO as a going-concern would not be liquidated. Furthermore, Schedule C to Exhibit 3 includes, without explanation, a trustee fee calculation which would not be paid if the Amended Plan is confirmed.

- Exhibit 3 to the Disclosure Statement should be revised to address these deficiencies.

4. The Disclosure Statement Lacks Adequate Information About the Pending Litigation

41. Although the Disclosure Statement provides a lengthy discussion of the Pending Litigation, it fails to describe the litigation in a way that would allow creditors and equity security holders to make an informed judgment about the Amended Plan. (D.S. at 11-17.) The Disclosure Statement provides a general summary of each law suit comprising the Pending Litigation and concludes each summary with a description of the basis for SCO's belief that it will prevail on its remaining claims or appeals. Although it notes that the other party "has and will dispute all of the above" (which may be obvious, else there would not be litigation), it omits any disclosure of each counterparty's position. Furthermore, including a statement that "the Causes of Action have been described and identified with as much particularity as is practicable and appropriate at this time ..." is not meaningful disclosure without providing the basis for such conclusion. (D.S. at 20.) "Adequate information" under Section 1125 requires more.

- The Disclosure Statement should describe both sides of the issues in the Pending Litigation, including the possibility that the counterparty may have a stronger basis for its claims or appeals on the merits (not just that each is a "large and financially potent adversary") than SCO has against such counterparty, so that creditors and equity security holders may evaluate the potential rewards and risks of the Pending Litigation and its affect on the Amended Plan.

5. The Disclosure Statement Lacks a Complete Or Accurate Description Or Valuation of The Debtors' Assets and Sufficient Detail Regarding the Condition of The Debtors During The Pendency of These Chapter 11 Cases

42. A disclosure statement must provide a complete and accurate description and valuation of the Debtors' assets and business operations and sufficient detail with respect to the condition and performance of Debtors during their Chapter 11 cases, especially here, where the Amended Plan contemplates the continuation to some unspecified degree of the Debtors' current business, as well as continuing deferred payment obligations and the possible issuance of equity securities.

43. The Disclosure Statement characterizes SCO as an "important industry player" for the past 30 years, with a business strategy that "contributed significantly to the growth of the computer industry ...". (D.S. at 22.) This characterization appears inconsistent with other statements about SCO's history, for example, the description of the history of SCO's acquisition of intellectual property rights related to its business:

SCO Group acquired certain rights relating to the UNIX (including UnixWare) source code and derivative works and other intellectual property rights when it purchased substantially all of the assets and operations of the server and professional services groups of The Santa Cruz Operation, Inc. in May 2001. The Santa Cruz Operation had previously acquired such UNIX source code and other intellectual property rights from [Novell] in 1995. Novell had acquired its rights from UNIX System Laboratories, a subsidiary of AT&T.

(Id. at 9.)

- The Disclosure Statement should, at a minimum, provide information to substantiate its misleading claim to 30-year continuity as an "important industry player", including the extent to which employees of SCO Group or its predecessors followed the chain of ownership from AT&T

to UNIX System Laboratories to Novell to The Santa Cruz Operation, Inc. and finally to SCO Group, so as to reconcile SCO's assertion of its ostensible 30-year history with the acquisition timeline provided in the Disclosure Statement.

44. The Disclosure Statement provides a list of domestic and foreign subsidiaries of the SCO Group (D.S. at 3.), followed by a statement that, "[a]s of January 6, 2009, the Debtors and their foreign subsidiaries and affiliates had a total of 66 full and part-time equivalent employees employed in various capacities including, but not limited to, finance, human resources, executive management and information systems ...". (*Id.* at 3.) The disclosure is incomplete and confusing.

- The Disclosure Statement should inform creditors and equity security holders: (i) whether the total of 66 employees includes employees of domestic subsidiaries of the Debtors; (ii) in what manner "part-time equivalent employees" are counted towards the total of 66 employees; and (iii) whether the total of 66 employees includes personnel in fields such as research and development or sales and marketing or whether such work is strictly handled by independent contractors.

45. The Disclosure Statement informs creditors and equity security holders that its "Americas team has field sales and support personnel located around the United States, Latin American and Canada ..." and further states that "[t]he Debtors, through their non-debtor affiliates and subsidiaries, have resources, employees and/or contractors in the United Kingdom, Germany, France, Italy, China, Korea, Netherlands, Eastern Europe, India,

and Japan”. (D.S. at 8.) Such disclosure is inadequate to provide the creditors and equity security holders with sufficient background and insight into the Debtors’ business.

- The Disclosure Statement should provide creditors and equity security holders with (i) details as to the total number and location of the Debtors’ field sales and support personnel; (ii) additional information as to the types of “resources” and number of contractors in each of the countries listed; and (iii) an explanation as to why Taiwan, Israel and Australia were included among the countries listed in the original disclosure statement filed February 29, 2008 [Docket No. 369] and have not been included in the Disclosure Statement.

46. When describing the Debtors’ UNIX business, the Disclosure Statement says in part, “SCO Group’s largest source of revenue for its core UNIX business is derived from its worldwide, indirect, leveraged channel of distributors and independent solution providers (“resellers”). The Debtors have employees or contractors in a number of countries that provide support and services to customers and resellers ...” and that “[i]n addition, SCO Group sells its UNIX products to original equipment manufacturers ...”. (*Id.* at 4-5.)

- The Disclosure Statement should provide additional information about “resellers” if they are SCO’s largest source of revenue for its UNIX business;
- The Disclosure Statement should provide information about “employees or contractors” providing support to the “resellers” as well as the

original equipment manufacturers to whom SCO sells its UNIX products; and

- The Disclosure Statement should also provide information about the identities (if material) and number of “resellers” and original equipment manufacturers and the number of “employees or contractors”; whether there is any concentration risk, such as a single “reseller” or a group of “resellers” or a single original equipment manufacturer or group of original equipment manufacturers that accounts for a disproportionate share of the total revenue; and whether there have been any changes in revenue over the course of these Chapter 11 cases attributable to a reduction in resellers, original equipment manufacturers or employees or contractors entering into transactions with the Debtors.

47. The Disclosure Statement says, “SCO Group has business relationships with a number of key global industry enterprises. These relationships encompass product integration, two-way technology transfers, product certification, channel partnerships and revenue generating initiatives in areas of product bundling, OEM agreements and training and education” and continues, “[m]ost of SCO Group’s small business customers that cannot afford high-end solutions or an information technology staff rely on one of SCO Group’s channel partners for these services. Maintaining these strategic alliances is critical to the success of SCO Group’s UNIX business.” (D.S. at 7-8 (emphasis added).)

- Because the Disclosure Statement says it is “critical to the success of SCO Group’s UNIX business” that strategic alliances be maintained,

the Disclosure Statement should provide additional information about such business partners and the specific nature of such relationships; in particular, the extent to which such relationships may be in danger of termination and the effect, if any, of these Chapter 11 cases or the Debtors' recent business performance on such relationships.

48. The Disclosure Statement says, "SCO Group has taken steps to improve its UNIX software products to maintain system reliability, maintain backward compatibility, increase application support, provide broad hardware support, better integrate widely used internet applications, improve usability, and increase system performance." (D.S. at 9.) Such a statement with respect to actions taken by the Debtors, without more, does not constitute "adequate information".

- At a minimum, the Disclosure Statement should provide additional information about when such steps were taken, the respective costs and levels of investment involved, the effect of such steps on reliability, compatibility, support, integration, usability and performance and the current or expected increase in revenues attributable to such improvements.

49. The Disclosure Statement says:

"[t]he success of SCO Group's mobility products and services offerings will depend, in part, on the outcome of the Pending Litigation, the level of commitment and resources the Debtors are able to devote to these offerings, the business relationships SCO Group is able to establish, its ability to attract and retain new customers and providers, and the strength of their mobility offerings..."

(D.S. at 10,11.) This statement demands clarification, especially given the assertion that the mobility products and services, which constitute a significant and substantial portion of the assets proposed to be sold in the Asset Sale, will depend for their success upon, in part, the outcome of the Pending Litigation. If such claim is correct, the implication is that the uncertainty relating to the Pending Litigation reduces the marketability and potential purchase price available for the mobility products and services.

- The Disclosure Statement should provide additional information to explain whether the saleability of the mobility businesses may, in fact, be dependent on the outcome of the Pending Litigation.
- The Disclosure Statement must also provide further detail as to the business relationships that SCO is seeking to establish.

50. The Disclosure Statement indicates that no provision is made in the Amended Plan to deal with intercompany debts, despite that such information is included in SCO Group's bankruptcy schedules. (See D.S. at 19.) The reason provided for not providing for intercompany debts is simply that "[w]hen the Debtors' consolidated financial statements [were] prepared, intercompany transactions and/or balances [were] removed." Such an explanation is insufficient.

- Because the Disclosure Statement currently provides only an accounting-based explanation for the election to disregard intercompany debts, which is insufficient as a legal matter to explain the elimination of intercompany claims, further information must be provided to justify the apparent discrepancy between the actual bankruptcy schedules and the proposed treatment of intercompany debts.

51. The Disclosure Statement provides categorically that “[p]ursuant to the terms of the Asset Purchase Agreement between [York Capital Management (“York”)] and the Debtors, SCO [sic] agreed to pay York up to \$150,000 as an expense reimbursement if the transaction did not close.” (D.S. at 20). Based upon the history of these Chapter 11 cases, that statement is inaccurate or misleading. While the questions of whether such a sale agreement was executed or even fully negotiated remain unanswered, it is clear that Debtors’ attempt to sell substantially all their assets to York was rejected by this Court because of, among other things, the Debtors’ inadequate disclosure of what the transaction comprised. (See Transcript of November 16, 2007 hearing (filed November 27, 2007) at 38:1-39:15; Opinion 11 & n.7.)⁶ A “moral obligation” to provide an expense reimbursement should not be sufficient to support an obligation to provide York with an expense reimbursement.

- The Disclosure Statement should provide additional evidence and definitive documentation to support the claim that York is owed up to \$150,000 as an expense reimbursement.

52. The Disclosure Statement describes in detail the proposed modification of the 2004 Omnibus Stock Incentive Plan under the Amended Plan but fails to disclose the total number of stock options currently outstanding. (D.S. at 29; Amended Plan at 11-12).

- The Disclosure Statement should provide complete information about the 2004 Omnibus Stock Incentive Plan.

⁶ Because the Debtors were unable to get approval of the transaction without making the key documents available, the Debtors withdrew their sale motion altogether on November 20, 2007). [Docket No. 225.]

6. The Disclosure Statement Lacks Information Regarding The Potential Business Risks Posed If The Reorganized Debtors Proceed Under The Amended Plan

53. Where a Chapter 11 plan provides for major continuing payment obligations and the potential issuance of equity securities, as is the case here, the Disclosure Statement must describe the potential risks to the reorganized debtor's earning capacity and financial viability and to the reorganized debtor's ability to meet the plan's payment provisions. Although the Disclosure Statement dedicates an entire Article to "Risk Factors", the three risk factors described relate only to confirmation of the Amended Plan and to the outcome of the Pending Litigation. Conspicuously absent is any disclosure at all of the potential business risks posed to creditors and equity security holders if the reorganized Debtors proceed under the Amended Plan.

- The Disclosure Statement should contain a robust statement of risk factors about the reorganized Debtors' business and the risks to recovery on claims and interests.

7. The Disclosure Statement Lacks Adequate Information Regarding The Potential Federal Tax Consequences Under The Amended Plan

54. While the Disclosure Statement provides a lengthy description of the Federal tax consequences to the Debtors, it provides far less meaningful disclosure with respect to the Federal tax consequences to creditors and equity security holders. (D.S. at 46-52.) The Debtors attempt to solve the lack of detail by including a disclaimer that provides that the holders of any claim "should consult with their own tax advisors regarding the U.S. federal income tax consequences resulting to them" from payment of the claims or confirmation of the Amended Plan. (*Id.* at 46-52.) Such a disclaimer is not sufficient to cure

inadequate disclosure about the material Federal tax consequences to creditors and equity security holders.

- The Disclosure Statement should describe the material Federal tax consequences of the Amended Plan to creditors and equity security holders.

Conclusion

For the foregoing reasons, IBM respectfully requests that this Court deny the Motion unless SCO supplements the Disclosure Statement to provide adequate information about the matters set forth above.

Dated: February 18, 2009

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