

**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: November 6, 2007 at 2:00 p.m. (ET)
Objection Deadline: October 23, 2007 at 4:00 p.m. (ET)

**NOVELL, INC.'S MOTION FOR ORDER DIRECTING
THE DEBTORS TO REMIT UNDISPUTED FUTURE SVRX ROYALTIES
TO NOVELL UPON RECEIPT**

Novell, Inc. ("Novell") hereby moves pursuant to sections 541(d) and 105(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.* (the "Bankruptcy Code") for an order directing the debtors to remit future software royalties to Novell when received. By operation of law and by agreement, these royalties are and will be Novell's property; they are *not* property of the estate. Without the benefit of the relief it seeks, which merely gives effect to Novell's express rights without intruding on the debtors' interests, Novell risks loss of these funds in the debtors' hands.

In support of this Motion, Novell relies on the Affidavit of Greg Jones (the "Jones Aff."), which is filed herewith, and states as follows:

PRELIMINARY STATEMENT

1. In 1995, Novell transferred certain UNIX software-related assets to The Santa Cruz Operation, Inc., predecessor in interest of The SCO Group, Inc. ("SCO"), via an Asset Purchase Agreement (as amended, the "APA"). Novell, however, retained all copyrights.

2. The transferred assets include SVRX software licenses (the “SVRX Licenses”),¹ which generate an undisputed royalty stream for Novell.² For these licenses, SCO services the underlying accounts as needed, collects the royalties when due and remits 100% of them to Novell quarterly. In return, SCO retains a 5% administration fee. Novell retains the right under the APA to unilaterally reclaim the preexisting SVRX Licenses and collect 100% of the royalties itself. Were Novell to exercise this right – which it may do at its pleasure at any time under the express terms of the APA – SCO would be deprived of its 5% fee.

3. SCO and Novell agreed on the royalty program in the APA, which provides that (among other things):

- SCO has only “legal title and not an equitable interest in such royalties within the meaning of Section 541(d) of the Bankruptcy Code.” APA § 1.2(b).
- “All right, title and interest to the SVRx [sic] Royalties, less the 5% fee for administering the collection thereof pursuant to Section 4.16 hereof” are excluded from the transfer. APA, Schedule 1.1(b)(VIII).
- “Within 45 days of the end of each fiscal quarter of [SCO], [SCO] shall deliver to [Novell] or [Novell’s] assignee 100% of any SVRX Royalties collected in the immediately preceding quarter.” APA § 4.16(a).
- SCO is required “to [re]assign any rights to . . . any SVRX License to the extent so directed in any manner or respect by” Novell. APA § 4.16(b).

4. SCO’s next payment is due to Novell on November 14, 2007 for collections made between July 1, 2007 and September 30, 2007 (collectively with other future remittances, the “Undisputed Future SVRX Royalties”).

¹ The software industry refers to certain versions of UNIX as “SVRX,” which stands for System V, Release X. “X” is the generic placeholder for the release number: System V, Release 1; System V, Release 2; and so on.

² SCO collects other royalties that also belong to Novell, but these are in dispute to some degree and therefore not subject to this Motion. The undisputed and disputed royalty streams shall be collectively referred to in this Motion as the “SVRX Royalties.”

5. Although under the APA SCO is required to pay Novell quarterly, this Court should order SCO to immediately remit the Undisputed Future SVRX Royalties to Novell when received. This relief is appropriate for two reasons. First, by agreement and under section 541(d) of the Bankruptcy Code, the Undisputed Future SVRX Royalties are and will be Novell's property when SCO collects them. They do not and will not belong to the estate. In fact, a constructive trust in the Undisputed SVRX Royalties for Novell's exclusive benefit arises the moment SCO receives them. Second, SCO's historical financial performance suggests that SCO may not have the funds to pay Novell at the end of each quarter. Thus, absent SCO's immediate remittance of the royalties to Novell, SCO may improperly use Novell's property to fund SCO's bankruptcy, making Novell a forced lender of new high-risk loans to the estate. Indeed, this would turn Novell's property into an involuntary gift to the estate and its creditors. Nothing in the APA or Bankruptcy Code sanctions SCO's use of Novell's property this way. To the contrary, the APA supplies Novell with a remedy expressly to avoid this very problem.

6. If granted, this relief would not harm the estate. SCO would, for the present, continue to service the underlying accounts, earn its 5% fee, and receive any other potential benefit from the preexisting SVRX Licenses.

JURISDICTION

7. The Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). The statutory predicates for the relief sought herein are sections 541(d) and 105(a) of the Bankruptcy Code.

GENERAL BANKRUPTCY CASE BACKGROUND

8. SCO and its affiliate, SCO Operations, Inc. (collectively with SCO, the “Debtors”), filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code on September 14, 2007. On September 18, 2007, this Court entered an Order directing joint administration of the Debtors’ estates.

FACTUAL BACKGROUND

9. SCO and Novell have been litigating their respective rights under the APA before the United States District Court for the District of Utah (the “District Court”) for almost four years. Jones Aff., ¶8. A copy of the APA is attached to the Jones Aff. as Exhibit “A.”

10. On August 10, 2007, the District Court ruled on cross motions for summary judgment (the “District Court Rulings”). The District Court Rulings determined that, under the APA, SCO is required to collect Novell’s SVRX Royalties for, and remit them to, Novell on an ongoing basis:

Under the APA, Novell and SCO agreed to an arrangement whereby Novell would continue to receive one hundred percent of the SVRX Royalties. [SCO] was to collect and pass through these royalties to Novell, and Novell, in turn, would pay [SCO] an administrative fee of five percent of the SVRX Royalties.

District Court Rulings, at 31 (citation omitted).³ See also District Court Rulings, at 98 (“The APA obligates SCO to give detailed monthly reports and to comply with audits. APA §§ 1.2(b), (f). To the extent that SCO has failed to comply with these requirements with respect to the 2003 Sun and Microsoft Agreements, the court notes that it has a continuing duty to fulfill its contractual obligations. Novell also has continuing rights under the APA to conduct audits as to SVRX Royalties.”) and 101 (“However, the court also notes that SCO has a continuing

³ SCO and some of its affiliated entities are required to remit SVRX Royalties generated worldwide. The only SVRX Royalties subject to this Motion are those remitted by SCO, not by its affiliated entities.

contractual obligation to comply with the accounting and reporting requirements set forth in the APA.”).

11. For purposes of this Motion, there are two types of licenses that generate or will generate SVRX Royalties: first, the SVRX Licenses that originated before the APA; and second, licenses SCO entered into after the APA, including the so-called “SCOsource” licenses and buyout licenses with Sun Microsystems, Inc. and Microsoft Corp. in 2003 (collectively, the “Sun and MS Licenses”).

12. As to the Undisputed Future SVRX Royalties, SCO does not dispute that: (a) Novell retained all equitable title specifically for purposes of section 541(d) of the Bankruptcy Code; and (b) SCO agreed to remit 100% of these royalties to Novell, subject to SCO’s 5% administration fee. APA § 1.2(b); District Court Rulings, at 4, 31-32.

13. With regard to the remaining licenses, the District Court found that SCO is liable to Novell for SVRX Royalties because at least some portion of those licenses used the SVRX product. District Court Rulings, at 94, 98, 101. However, the District Court was unable to determine the dollar amount of these royalties in the context of summary judgment because the portion of SVRX product contained in each agreement remained a question of fact. District Court Rulings, at 98, 101. Accordingly, the amount of SVRX Royalties SCO owes to Novell for the Sun and MS Licenses and other SCOsource licenses is presently disputed (the “Disputed SVRX Royalties”).

14. The District Court scheduled a trial for September 17, 2007 to determine the Disputed SVRX Royalties, among other things. Jones Aff., ¶15. However, on the eve of that trial and one full month after the District Court Rulings, SCO filed for bankruptcy. As Novell is concurrently filing a lift-stay motion to allow the District Court to continue with that litigation in

order to address the apportionment issues (among other things), Novell does not seek relief in this Motion with respect to the Disputed SVRX Royalties. Accordingly, only the Undisputed Future SVRX Royalties are subject to the relief requested in this Motion.

15. From the third quarter 2006 through the second quarter 2007, SCO remitted a total of \$696,413.67 in undisputed SVRX Royalties to Novell. Jones Aff., ¶4. Novell estimates that SCO will be required to remit between \$500,000 and \$800,000 annually in Undisputed Future SVRX Royalties. Jones Aff., ¶5. The first Undisputed Future SVRX Royalty is due on November 14, 2007, which will include payments collected by SCO between July 1, 2007 and September 30, 2007. Jones Aff., ¶6.

RELIEF REQUESTED

16. Novell respectfully requests that this Court enter an Order directing SCO to remit the Undisputed Future SVRX Royalties to Novell immediately upon receipt.

ARGUMENT

A. Summary Of Argument

17. As Novell's collection agent, SCO owes Novell Undisputed Future SVRX Royalties collected or to be collected going forward. The APA provides that SCO is required to make these remittances quarterly. However, using its general equitable powers under Bankruptcy Code section 105(a) this Court should order SCO to remit these amounts to Novell immediately upon receipt instead because: (a) the royalties are and will be Novell's property under section 541(d) of the Bankruptcy Code when collected, not estate property, so upon receipt, SCO will be required to hold them in trust for Novell's exclusive benefit; (b) SCO's cash may be depleted before the next or later Undisputed Future SVRX Royalties come due under the APA.

B. The Undisputed Future SVRX Royalties Are Not And Will Not Be Property Of The Estate When Received And SCO Is Required To Hold These Amounts In Trust For Novell

18. The bankruptcy estate comprises “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). However, property in which a debtor holds bare legal title but not an equitable interest is not property of the estate. 11 U.S.C § 541(d); *Kaiser Aluminum & Chemical Corp. v. Transcontinental Ins. Co. (In re Kaiser Aluminum Corp.)*, 2004 Bankr. LEXIS 33, at *9, Main Case No. 02-10429 (JKF), Adv. Pro. No. 02-6531 (JKF) (Bankr. D. Del., January 16, 2004) (excluding from property of estate funds in which debtor held legal interest but no equitable interest, and where agreement with third party showed third party’s superior interest in the funds); *EBS Pension LLC v. Edison Bros. Stores (In re Edison Bros.)*, 243 B.R. 231, 235 (Bankr. D. Del. 2000).

19. Here, as the District Court determined on summary judgment, the APA establishes that SCO’s interest in the Undisputed Future SVRX Royalties is merely legal, not equitable, specifically so that they would be excluded from SCO’s bankrupt estate in accordance with section 541(d) of the Bankruptcy Code. The APA also specifies that Novell retained all equitable title. Thus, they are and will be Novell’s property when received by SCO, not property of the estate.

20. Furthermore, the law requires SCO to hold the Undisputed Future SVRX Royalties in trust for Novell. “The legislative history of section 541(d) makes clear that when a debtor collects money on behalf of another, this money is held in constructive trust for the intended eventual recipient even absent any misconduct.” *EBS Pension LLC v. Edison Bros. Stores (In re Edison Bros.)*, 243 B.R. at 235. Thus, even if it wanted to use the funds for other

purposes, SCO is prohibited from doing so. Instead, it must hold them in trust for Novell's exclusive benefit.

C. The Debtors May Not Be Able To Pay The Undisputed Future SVRX Royalties As Agreed In The APA

21. SCO may not have the funds to pay Novell at the end of each quarter.

Historically, SCO's financial performance has been poor. Indeed, the District Court Rulings noted that "SCO has had financial problems, posting operational losses for all years except 2003," the year SCO wrongfully retained the proceeds of the Sun and Microsoft Agreements it entered into that year. District Court Rulings, at 42 (citing exhibits to Declaration of Michael Jacobs).⁴ The Debtors' financial trouble will only be exacerbated by its bankruptcy filing, a step that typically compromises a debtor's relationships with customers, account debtors and vendors. Thus, it does not appear that the Debtors' financial position will improve any time soon. Indeed, they may run low on or even completely out of cash during the process of trying to reorganize.⁵ Thus, absent immediate remittance, SCO may use Novell's property to fund SCO's bankruptcy for its own benefit and that of its other creditors to Novell's prejudice.

22. Putting Novell's Undisputed Future SVRX Royalties at risk would, in essence, transform Novell into a forced lender of high risk loans to the estate not through perpetuation of an existing loan, but through the creation of a loan where there was none before. This was not something intended by the parties in the APA, which gave Novell the right to reclaim the SVRX licenses and the collection of their royalties in its sole discretion precisely to enable it to protect itself against SCO as a credit risk. Indeed, Novell could seek to exercise its rights under APA

⁴ SCO's very right even to enter into those licenses is itself one of the issues remaining for trial.

⁵ Bankruptcy courts are especially sensitive about protecting a party's interest in cash. *See, e.g. O'Donnell v. Royal Business Group, Inc. (In re Oxford Homes, Inc.)*, 180 B.R. 1, 31-32 (Bankr. D. Me. 1995) (noting that Bankruptcy Code "acknowledges that cash and cash equivalents are highly susceptible to diversion and loss.") Here, that concern is magnified because the cash involved unquestionably is Novell's.

Section 4.16 forthwith, thereby denying SCO the ability even to earn its 5% administrative collection fee. Nor is such a forced “loan” of another’s property authorized anywhere in the Bankruptcy Code.

D. Section 105(a) Of The Bankruptcy Code Gives The Court The Authority To Award The Relief Requested Here

23. Under section 105(a) of the Bankruptcy Code, the Court has ample authority to order SCO to immediately remit the Undisputed Future SVRX Royalties to Novell. Section 105(a) gives the Court the power to “issue any order, process or judgment that is necessary or appropriate to carry out the provisions of” title 11. 11 U.S.C. § 105(a). It “is a powerful, versatile tool that empowers bankruptcy courts and district courts sitting in bankruptcy to fashion orders in furtherance of Bankruptcy Code provisions.” *Joubert v. ABN AMRO Mortgage Group, Inc.*, 411 F.3d 452, 455 (3d Cir. 2005). Thus, bankruptcy courts’ equitable powers enable them to “sift the circumstancesto see that injustice or unfairness is not done in the administration of the estate.” *Pepper v. Litton*, 308 U.S. 295, 307-08 ((1939). *See also, e.g., Sears Roebuck & Co. v. Spivey*, 265 B.R. 357, 371 (E.D.N.Y. 2001) (Section 105(a) “bestows on bankruptcy courts a specific equitable power to act in accordance with principles of justice and fairness[and gives] [b]ankruptcy courtsbroad power latitude in exercising this power”) (citation omitted).

24. *Dobin v. Presidential Financial Corporation of Delaware Valley (In re Cybridge Corp.)*, 312 B.R. 262 (D.N.J. 2004), illustrates the creativity allowed bankruptcy courts under section 105(a) to serve principles of equity and fairness for nondebtors such as Novell as much as for debtors. In that case, the debtor filed a bankruptcy without telling its secured factor it had done so. The factor continued to collect and apply payments on the factored receivables due to the debtor from its customers and continued to make new advances to the debtor, as well. The

debtor's trustee sued the factor to recover the receivables the factor received and applied postpetition as unauthorized transfers. The bankruptcy court ruled for the trustee but it also allowed the factor to, in essence, set off those unauthorized payments against the further advances it had made postpetition. Citing the general equitable powers of section 105(a), the district court affirmed this special relief for the factor, even though it is not expressly provided for in the Bankruptcy Code as a defense to the trustee's claim. In affirming the bankruptcy court, the district court wrote:

We further find that the Bankruptcy Court's exercise of its Section 105(a) powers, rather than conflicting with the Code, actually furthers its aims. "It is not the objective of the bankruptcy laws to confer windfalls on debtors." *In re Chicago, Milwaukee, St. Paul & N. W. Ry. Co.*, 791 F.2d 524, 527 (7th Cir. 1987).

Dobin, 312 B.R. at 272-73.

25. Here, Novell simply is asking the Court to fashion relief consistent with protecting Novell's property rights that are specifically recognized under section 541(d) so that this bankruptcy does not jeopardize those rights and provide SCO with a windfall.

26. The relief that Novell seeks here is far from extraordinary. Indeed, Novell only seeks the equivalent of a subset of what it could already accomplish at its sole discretion under APA Section 4.16 by having the SVRX Licenses reassigned to it. Moreover, in asking for this relief, it is willing (for the moment) to leave the job of royalty collection in SCO's hands, thereby allowing SCO to continue to earn its 5% commission on collections, even though it also could deprive SCO of that function and income by exercising its reassignment rights under Section 4.16.

27. All Novell is asking this Court to do under its equitable powers, therefore, is to provide Novell with fair and entirely reasonable protection of Novell's property interests without otherwise affecting SCO's interests.

CONCLUSION

28. The parties never intended that the SVRX Royalties be SCO's property, either in or out of bankruptcy; in fact, they expressly agreed to the contrary. The Bankruptcy Code does not change this relationship, nor does it permit SCO to hijack Novell's funds. Moreover, in the APA itself the parties gave Novell the absolute right to take steps to protect its property by demanding reassignment of the SVRX Licenses whenever it chose. Accordingly, Novell submits that the Court should order the relief requested in this Motion. What Novell seeks here is, in essence, an order implementing that bargain-for safeguard of its Bankruptcy Code-protected property rights.

WHEREFORE, Novell respectfully requests that the Court enter an order:

1. Directing SCO to remit the Undisputed Future SVRX Royalties to Novell immediately upon receipt; and
2. Granting Novell such other and further relief as the Court deems just and proper.

Dated: October 4, 2007
Wilmington, Delaware

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