

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE: . Chapter 11
The SCO GROUP, INC., *et al.*, .
 . Case No. 07-11337(KG)
 . (Jointly Administered)
 .
 . September 18, 2007
 . 8:30 a.m.
Debtors. . (Wilmington)
 .

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE KEVIN GROSS
UNITED STATES BANKRUPTCY COURT JUDGE

Proceedings recorded by electronic sound recording;
transcript produced by transcription service.

INDEX

ADMITTED

EXHIBIT FOR THE DEBTOR:

EXHIBIT 1 - Affidavit of Darl C. McBride, Chief
Executive Officer 37

1 THE CLERK: All rise.

2 THE COURT: Good morning everyone. Please be
3 seated.

4 UNIDENTIFIED SPEAKER: Good morning.

5 UNIDENTIFIED SPEAKER: Good morning, Your Honor.

6 UNIDENTIFIED SPEAKER: Good morning, Your Honor.

7 THE COURT: Thank you. Ms. Jones, good morning.

8 MS. DAVIS JONES: Good morning, Your Honor.

9 THE COURT: And I think we have, just for the
10 record, Mr. Singerman on the phone?

11 MR. SINGERMAN (Telephonic): Yes. Good morning, Your
12 Honor. I'm Paul Singerman from Berger Singerman. Our firm
13 is prospective co-counsel for the Debtors along with Ms.
14 Jones.

15 THE COURT: Good morning, sir.

16 MR. SINGERMAN (Telephonic): Good morning, Your
17 Honor.

18 THE COURT: Ms. Jones, good morning.

19 MS. DAVIS JONES: Good morning, Your Honor. For the
20 record, Laura Davis Jones of Pachulski, Stang, Ziehl, & Jones
21 on behalf of SCO Group, Inc. and SCO Operations Group. I'm
22 sorry, SCO Operations, Inc. Your Honor, these are Chapter 11
23 cases that we filed on Friday. And Your Honor, let me start
24 by thanking you for giving us time this morning. We know
25 you're in the middle of a busy trial, and we appreciate you

1 accommodating our schedule.

2 THE COURT: My pleasure.

3 MS. DAVIS JONES: Your Honor, let me start if I may
4 by making a few introductions.

5 THE COURT: Yes.

6 MS. DAVIS JONES: And I think others may want to as
7 well. Your Honor, I introduce to the Court Darl McBride,
8 who's the Chief Executive Officer of the Debtors.

9 THE COURT: Good morning Mr. McBride. Welcome.

10 MR. McBRIDE: Good morning, Your Honor.

11 MS. DAVIS JONES: And we filed Mr. McBride's
12 affidavit in support of the first day motions.

13 THE COURT: Yes.

14 MS. DAVIS JONES: Your Honor, I'd also introduce to
15 the Court Ryan Tibbetts, who's our general counsel.

16 THE COURT: Mr. Tibbetts, good morning.

17 MS. DAVIS JONES: Your Honor, I have the pleasure of
18 being co-counsel with both Mr. Singerman, who's on the phone,
19 and also Arthur Spector, here at counsel table, from the
20 Berger Singerman firm.

21 THE COURT: Welcome Mr. Spector.

22 MS. DAVIS JONES: And Mr. Spector's motion for *pro*
23 *hac vice* is pending, Your Honor.

24 THE COURT: Thank you.

25 MS. DAVIS JONES: And Your Honor, I'd also introduce

1 to the Court Stuart Singer of the Boies Schiller firm who is
2 litigation counsel.

3 THE COURT: Good morning.

4 MR. SINGER: Good morning, Your Honor.

5 MS. DAVIS JONES: Your Honor, I'm going to step back
6 and let others make some introductions.

7 THE COURT: And Mr. O'Neill needs no introduction.

8 MR. O'NEILL: Good morning, Your Honor.

9 THE COURT: Good morning.

10 MS. DAVIS JONES: I'll step back and make a, let
11 others make a few introductions if I may.

12 THE COURT: Certainly, Ms. Jones. Thank you. Mr.
13 Nestor, good morning, sir.

14 MR. NESTOR: Good morning, Your Honor. I'd like to
15 introduce Larren Nashelsky, as I'm sure Your Honor is
16 familiar.

17 THE COURT: Yes.

18 MR. NESTOR: He's here on behalf of Novell. We
19 filed *pro hac* papers yesterday for he and his colleagues,
20 some of whom are in court today.

21 THE COURT: Thank you, Mr. Nestor.

22 MR. NESTOR: Thank you, Your Honor.

23 THE COURT: Welcome.

24 MR. NASHELSKY: Good morning, Your Honor.

25 THE COURT: Good morning.

1 MS. DAVIS JONES: Your Honor, we have filed an
2 amended agenda of matters scheduled for hearing this morning.
3 Your Honor, I did note on that amended agenda that, or the
4 amended notice of first day hearings that there are, the Epiq
5 motion was listed as going out on notice. Your Honor, we
6 have been able to work out those issues with Mr. McMahon, and
7 we'll address that motion today if we may.

8 THE COURT: Yes.

9 MS. DAVIS JONES: And Your Honor, we've spent quite
10 a bit of time with Mr. McMahon, and he has made himself
11 available late into last night, and very early this morning,
12 and we appreciate that. And I think we've worked out all the
13 issues that we have with the Trustee's office, but we'll
14 address those as we go. Your Honor, what I'd like to do,
15 though, first if I may, is yield to Mr. Spector to give Your
16 Honor a little bit of background on the case and where we see
17 it going forward.

18 THE COURT: Yes, Ms. Jones. Thank you. Mr.
19 Spector.

20 MS. DAVIS JONES: Thank you.

21 MR. SPECTOR: Good morning again, Your Honor.

22 THE COURT: Good morning.

23 MR. SPECTOR: On September 14th, 2007, that was
24 Friday, the SCO Group, Incorporated, and SCO Operations,
25 Incorporated, collectively we'll call them SCO, petitioned

1 the Court for voluntary, voluntary petition for relief under
2 Chapter 11 for each of those companies. The Debtors are
3 located in Lindon, Utah. That's their headquarters. They
4 have domestic offices as well in California and New Jersey.
5 The company also operates overseas in locations in the United
6 Kingdom, France, India, and Japan. SCO owns, distributes,
7 licenses, and services Unix operating systems across the
8 United States and worldwide. For the three months ending
9 July 31st, 2007, the SCO Group's revenue was approximately
10 \$4.7 million. Compared to about \$7.4 million in the like
11 period in the prior year. For the nine month period ending
12 July 31st, SCO Group's revenue was a hundred, pardon me,
13 \$16,700,000 compared with \$21.9 million for the same nine
14 month period the prior year. SCO also has a fledgling
15 product besides handling the Unix operating systems called
16 SCO Mobile. Which, if allowed to mature, could become quite
17 profitable. It's a product that allows an organization such
18 as a school to reach, by voice mail, large numbers of people
19 at one time. In Florida we like to use that, employers will
20 call when there's a hurricane and things like that. It's a
21 growing technology, and it's very useful in the real world.
22 In many parts of the world, like India, hundreds of millions
23 of people have computers, but no desk tops. They have cell
24 phones to their computers. Mobility products, as they're
25 called, will have people operate their current operations

1 that would now be on a desktop out of their cell phones. And
2 not just the ones that they do now, functions they do now,
3 but functions that haven't been invented yet. SCO is pleased
4 to be listed by the industry analyst, IDC, recently as among
5 the leaders in this type of technology. Joining the ranks of
6 Microsoft, and RIM, and Motorola, and the like. And so with
7 that as a future platform of success and the Unix software
8 business that is, has been the foundation of the company,
9 this company looks to reorganize and become a profitable,
10 taxpaying, wage paying entity. The Debtors have no secured
11 debt, so this is a very unique case. And as of the end of
12 the third quarter, the Debtors had approximately \$2 million
13 in un, in liquidated, undisputed, non-contingent trade debt.
14 Besides owing a fiduciary duties, duty to its shareholders
15 and its creditors, SCO owes a heavy responsibility to its
16 customers. Seven out of the ten largest retail
17 establishments, I'm given to understand, operate off of
18 Novell operating system servers. I said Novell. We'll get
19 to them later. SCO - - that was, that was a mistake. SCO's
20 operating system - - pardon me. For example, I understand
21 the McDonald's software uses the SCO service system. Also
22 military, the US Military to some extent, uses, a large
23 extent, uses SCO servers in their critical operations. And
24 finally, a supplier of services to the New York Stock
25 Exchange and NASDAQ for retail trading works off of SCO

1 servers and operating systems. There are thousands of
2 customers, mid-size and large, throughout the world that rely
3 on the continued viability of SCO to, to maintain and service
4 their mission critical operations. This is not a company
5 without significant impact on world economics. At one time
6 SCO had approximately \$230 million in annual revenue. Today
7 that's down to \$20 million and falling. At one time, SCO had
8 an 83% Unix Intel market share. Today, due largely to
9 competition from freeware, such as LINUX, that percentage has
10 dropped to about 10% or less, and is still dropping. SCO
11 believes, and in its litigation expects to prove, that LINUX
12 is at least partially a knock off of the Unix, SCO's Unix
13 software and product. In making that claim in litigation,
14 SCO has taken on basically the entire industry. And they
15 fought back hard. With, among other things, a very large PR
16 budget. As a result, SCO has been actually experiencing
17 losses for most of its short life. Its cash position is down
18 to approximately \$10 million. SCO filed these cases to
19 stabilize its business, to ensure that it has its day in
20 court on a number of crucial issues, to have its breathing
21 spell anticipated and expected in a Chapter 11 case, and
22 critically, to protect its customers, who worry this instant,
23 while we are here, about the continued viability of SCO Unix.
24 Even now, management and the Board are working on business
25 solutions having nothing to do with this litigation, just

1 business solutions to work out, as you would expect a Chapter
2 11 Debtor to do right from the get go, and transactions that
3 may be brought, and we'd like to bring to this Court in the
4 very short future. We know that every story has at least two
5 sides, and we expect that others may give you a different
6 picture. We anticipate that, we welcome that, and we
7 anticipate responding to that at the appropriate time. But
8 in the meantime, we intend to keep the lines of communication
9 open with our friends on the other side of the courtroom, and
10 others as well. We look forward to coming to this Court with
11 a plan of reorganization, keeping our stay in this Court
12 successful but short. And we expect and hope that our
13 discussions will lead to an overall resolution, a business
14 resolution of our disputes in the context of an overall plan
15 of reorganization. With those background comments, Your
16 Honor, I would like to turn to some of the motions. And I
17 think Ms. Jones will take us through the first few non-
18 controversial ones. And I thank you for your time.

19 THE COURT: Thank you. Thank you, Mr. Spector. I
20 have read the declaration very carefully, and obviously the
21 motions as well, so you may proceed as you see fit, Ms.
22 Jones.

23 MS. DAVIS JONES: Thank you, Your Honor. Your
24 Honor, the first matter that's scheduled is the motion for
25 joint administration of the cases. Your Honor, these are two

1 affiliates. We're seeking to procedurally consolidate them,
2 nothing substantive, and we'd ask that that be approved, Your
3 Honor.

4 THE COURT: Unless there's any objection, I'm
5 prepared to approve that.

6 MS. DAVIS JONES: Your Honor, may I approach with a
7 form of order?

8 THE COURT: Yes, you may. Thank you.

9 MS. DAVIS JONES: Thank you.

10 THE COURT: Okay. Incidentally, there's no time
11 pressure. So just take your time.

12 MS. DAVIS JONES: Thank you, Your Honor. Your
13 Honor, the second matter is our motion to retain the Epiq
14 Group as our claims agent. Your Honor, Epiq has served as a
15 claims agent in numerous cases before this Court. We filed
16 the motion, Mr. McMahon had some comments to our form of
17 order and to their engagement letter, mainly going to
18 indemnification, limitation on liabilities. Epiq had already
19 removed the limitation on liabilities, but we wanted to
20 clarify what's been called the plan of Hollywood language
21 with respect to indemnification, and deal with some other
22 issues that Mr. McMahon has. Your Honor, I think this one
23 also is really pretty straightforward, and what I'd like to
24 do, if I may, Your Honor, is approach with a black line that
25 shows the changes that we agreed to with Mr. McMahon, as well

1 as a form of order, unless Your Honor has any other questions
2 on this.

3 THE COURT: No. That would be sufficient. Thank
4 you.

5 MS. DAVIS JONES: Thank you.

6 THE COURT: Thank you. Looks fine.

7 MS. DAVIS JONES: Thank you, Your Honor. Your
8 Honor, at this point, I think I'm going to yield to Mr.
9 Spector with respect to the business forms and the employee
10 wages, as well as the temporary employee motion, Your Honor.

11 THE COURT: Okay, Ms. Jones. Thank you. Mr.
12 Spector.

13 MR. SPECTOR: Your Honor, there are three remaining
14 motions. We've had a lot of talks with Mr. McMahon, as Ms.
15 Jones said, late into last night and into this morning as
16 well. And we think that those were very productive, and we
17 think we can resolve whatever loose ends may, are left, I
18 think we can resolve right now.

19 THE COURT: Okay.

20 MR. SPECTOR: The three motions that remain are the
21 bank account cash management motion, the wage motion, the
22 wage and employees motion, that is, and a temporary employees
23 motion. Comments are on all three of those. I'm given to
24 understand that for a Delaware case the requests that we have
25 here are fairly pedestrian and non-controversial, but where

1 there are issues, we'll be happy to address them. With, with
2 respect to the bank account and cash management motion, Your
3 Honor has read the declaration, the affidavit of Mr. McBride,
4 has read the motion. I don't want to go through all the
5 recitation of the reasons why, especially in something as
6 generally routine as this, to go through the reasons why such
7 a motion is necessary. I will address, however, some
8 agreements that we've reached with the US Trustee. The DIP
9 imprint on the business forms. The Debtor has agreed, the
10 Debtors have agreed that when their current stock of business
11 forms are expired, we will employ new printing, and in that
12 new printing we would imprint the DIP imprint that the US
13 Trustee has requested.

14 THE COURT: Yes.

15 MR. SPECTOR: Frankly, I have to tell Your Honor, we
16 hope that this case is done before that has to be done.
17 Subsidiaries are cash flow positive overall. That's
18 something that was a big issue with the US Trustee. Allow me
19 to explain that in a little bit more detail. Every company
20 has to have revenue to be successful at all, and some people
21 can just send out traveling salesmen around the world, some
22 people will have a sales office, but this is the company, and
23 it's a sales office at the company. This company has chosen
24 to set up subsidiary companies as their salesmen. And they
25 have a small staff in any one particular location around the

1 world. The sales that they generate get deposited directly
2 into Debtor Operations. Operations, the name of the company.
3 That Debtor, called Operations, bank account. So the money
4 that the sales offices generate go to the Debtor. And a lot
5 of times in software, the payments, the large revenues come
6 in at the end of a quarter, because the royalties are paid
7 that way. In the couple months that go up before the
8 quarter, a large, the sales, sales companies may be using the
9 money that's in the local bank accounts, but most of the
10 time, they would need some infusion to get to the end of the
11 quarter when it comes in. So there's cash flow going out,
12 and then when the royalties come in, the cash flow comes in.
13 And there are sales from time to time in the meantime as
14 well. As an aggregate, when you put the sales offices
15 together, it's always cash flow positive to Debtors. There's
16 no place else for it to go. And so we have no problem
17 agreeing with the US Trustee that if there should ever come a
18 time that the sales offices, the subsidiaries, the foreign
19 subsidiaries, turn out to be cash flow negative for a
20 quarter, as an aggregate, we will not fund into that, but
21 will come back to the Court for instruction and permission.
22 I can say that with confidence, because it doesn't make sense
23 to have sales offices that you have to support with nothing
24 coming back.

25 THE COURT: Yes.

1 MR. SPECTOR: And I'll move to the next one. I just
2 wanted to know if I stated that right to you. Okay. We also
3 agree, the Debtors agree to accept the 30 day waiver of the
4 345 requirements as typical. And we will endeavor to get the
5 bank to sign a collateralization agreement, or have to move
6 the funds, if it comes to that.

7 THE COURT: Yes.

8 MR. SPECTOR: Okay. I believe those are the
9 agreements we made on that motion, and I'll move on, then, to
10 the wage motion.

11 THE COURT: Mr. McMahon, was there anything further?
12 Why don't we just hear from you if there is anything on this
13 particular motion? I was going to give Mr. McMahon just an
14 opportunity while we're on this motion.

15 MR. SPECTOR: Of course.

16 MR. McMAHON: Your Honor - -

17 THE COURT: Good morning.

18 MR. McMAHON: - - good morning.

19 THE COURT: Good morning.

20 MR. McMAHON: Joseph McMahon for the United States
21 Trustee. Counsel has accurately described our agreements and
22 understandings.

23 THE COURT: Excellent. Thank you, Mr. McMahon.

24 MR. SPECTOR: I have a black line and an original
25 for Your Honor of the order. Can I hand that up?

1 THE COURT: Yes, Mr. Spector, you may approach.

2 Thank you. Mr. Nestor.

3 MR. NESTOR: Good morning again, Your Honor. As I
4 advised Mr. Nashelsky's in court today. We filed *pro hac*
5 papers yesterday.

6 THE COURT: Okay.

7 MR. NESTOR: We have some comments and concerns we'd
8 like to bring to the Court's attention with respect to that
9 motion. And if it pleases the Court, I'd ask that he be
10 admitted *pro hac* - -

11 THE COURT: Of course.

12 MR. NESTOR: - - for purposes of today. Thank you.

13 THE COURT: Welcome.

14 MR. NASHELSKY: Good morning. Thank you, Your
15 Honor.

16 THE COURT: Yes. Good morning.

17 MR. NASHELSKY: A pleasure to be in front of you.
18 Darren Nashelsky from Morrison & Forrester on behalf of
19 Novell, Inc. Novell is here today not to oppose the
20 bankruptcy filing at this time, and not to oppose the
21 substantive relief being requested by the Debtors. We're
22 here solely to protect and preserve Novell's rights, which I
23 just want to briefly describe to the Court, as it applies to
24 this motion and to the next two motions. As Your Honor is
25 aware, SCO filed these Chapter 11 cases the day before the

1 trial in Utah on Novell's counter claims. Those were counter
2 claims in case that SCO was the plaintiff bringing against
3 Novell. And to understand Novell's position on this motion
4 and in this case, I just need to briefly explain the
5 relationship between the parties. I'm going to try not to
6 get into too much detail. I'm not going to try to debate the
7 points here. It's not the time, it's not the place, but I
8 think Your Honor needs to understand our position so that I
9 can make the points as it respects the cash management
10 system. The key technology that Novell had purchased from
11 AT&T, the Unix technology was sold, Novell purchased it from
12 AT&T in 1993, and in 1995, Novell sold certain assets
13 comprising that business to SCO's predecessor, and retained
14 certain rights, specifically Unix and UnixWare copyrights,
15 and certain royalties from licenses. And with respect to
16 those royalties, SCO is Novell's agent. SCO collects
17 Novell's property, is allowed to retain a fee for collecting
18 those royalties, and then turns over those payments to
19 Novell. So it's Novell's property, SCO administers it, SCO
20 gets a fee, but it's Novell's property. The Utah action that
21 is one of the big issues, Your Honor, we'll hear about going
22 forward, was commenced in 2004 by SCO. They sued Novell in
23 State Court, and that was removed to District Court.

24 THE COURT: Um-hum.

25 MR. NASHELSKY: After SCO filed an amended

1 complaint, the parties filed some re-judgment motions, SCO
2 asserted that they owned the Unix and UnixWare copyrights and
3 Novell was interfering. Novell took the opposite position
4 that it was the rightful owner of the copyrights, and
5 payments arising from licenses, including payments that were
6 made to SCO by Sun and Microsoft. In a decision about a
7 month ago, on August 10th, Judge Kimball, District Court Judge
8 in Utah issued a 102 page decision denying SCO's motion for
9 summary judgment and granting, in part, Novell's motion for
10 summary judgment. And that decision held, in relevant part,
11 for this, that Novell is the rightful owner of the Unix and
12 UnixWare copyrights, Novell is the owner of the SVRX
13 royalties, and that with respect to certain payments made by
14 Sun and Microsoft that SCO impermissibly - - excuse me - -
15 converted those payments and converted Novell's property.
16 Now the trial that would have taken place yesterday was,
17 would have been short trial, Your Honor. Three to four days.
18 It was a trial solely on Novell's counterclaims in the
19 action. Novell was seeking to liquidate its claims against
20 SCO, get an actual dollar amount of what it was owed,
21 determine what portion of certain licenses SCO wrongfully
22 retained, and should be turned over to Novell as its
23 property, and to determine whether SCO had authority to enter
24 into certain types of agreements. What Novell wants from
25 Your Honor today, and down the road, would be to liquidate

1 those counterclaims as soon as possible. All the parties in
2 this case will need to know where SCO stands with respect to
3 Novell's claims, and Novell's property that Judge Kimball
4 determined SCO has converted. We will be bringing a lift
5 stay motion in short order which will request that Your Honor
6 lift the stay and permit us to liquidate those counterclaims.
7 Trial was set to happen yesterday, party is prepared, issues
8 were briefed, discovery completed, three to four days, we
9 think it's critical that that happens. We think it's more so
10 critical, because without it, Novell's counterclaims will not
11 be liquidated, and its rights with respect to its properties
12 determined, and we need to protect those rights. And here's
13 how, Your Honor, it applies to today's motion. And I'm not
14 just speaking for the sake of being heard. What we need is
15 with respect to the cash management system and the pre-
16 petition amounts. As I said, we don't have a substantive
17 problem with that. Where we have a problem is that the
18 orders that Your Honor is being asked to approve to pay those
19 amounts and use those funds have to be clear that they won't
20 prejudice Novell's rights with respect to monies that Judge
21 Kimball found were converted and are Novell's monies, and
22 have to make clear that Novell's property, property which is
23 not property of the estate under 541(d), where the Debtor
24 holds bare legal title, Novell hold equitable title, that
25 those monies are segregated and not used in the cash

1 management system and to pay any of these amounts that the
2 Debtors need to pay for pre-petition wages and other uses
3 that they've asked, they're asking the Court. With respect
4 to those revenues, there really are two categories. There's
5 undisputed SVRX royalties. These are royalties, as I said,
6 are the original contract Novell retained, SCO collects as
7 Novell's agent collect 100% of those royalties, and turns
8 them over to Novell, and receives an administrative fee of 5%
9 for doing that. There's never been a dispute that those
10 royalties are Novell's property. SCO has always turned those
11 over. The APA under which SCO acquired these assets made it
12 clear that SCO only had bare legal title. Judge Kimball
13 confirmed that in his decision, and what we need from Your
14 Honor is to make it clear in the order that those royalties
15 should be turned over to SCO, sorry, excuse me, to Novell
16 immediately, and should not be co-mingled with any of SCO's
17 other funds or used to fund its operations in any way, other
18 than the 5% fee that they're entitled to. We want to make
19 sure that any monies that SCO receives with respect to the
20 SVRX royalties at issue are turned over, whether those monies
21 come in to SCO, or come in through the subsidiaries Mr.
22 Spector was referring to, that are also part of the SVRX
23 royalties. To the extent those are, those need to be
24 immediately turned over and not co-mingled with any of the
25 other monies that the Debtors have. The second category,

1 Your Honor, are SVRX royalties which SCO has not remitted to
2 Novell, and which Judge Kimball found SCO converted and co-
3 mingled with its other funds. Despite their failure to remit
4 those, Novell is the equitable owner of the funds, and they
5 still are Novell's property. Judge Kimball found that SCO
6 breached its fiduciary duty to Novell by failing to account
7 for and remit certain of those payments, and specifically
8 certain of those payments that related to Sun and Microsoft
9 payments under their agreements. Judge Kimball found that
10 SCO's conduct was sufficiently wrongful conduct to impose
11 constructive trust. Constructive trust for the benefit of
12 Novell. The trial that would have occurred yesterday, Your
13 Honor, was to determine the amount of that constructive
14 trust. Judge Kimball was clear we're entitled to a
15 constructive trust, it's our property. It's complicated
16 because we're talking about licenses and agreements that have
17 various payments for various parts of those licenses, but he
18 was clear constructive trust was appropriate, and he was
19 going to decide how much. We believe until that
20 determination is made by Judge Kimball, the Court should
21 prohibit SCO from using any of those royalties for any
22 purpose, and that those should remain in escrow until Your
23 Honor permits Judge Kimball to hear the counter claims and
24 liquidate those claims, and liquidate the amount of Novell's
25 constructive trust. We also request that SCO provide a

1 detailed accounting of its royalties so that Novell can
2 monitor and understand which are its monies and which are the
3 estate's monies. Obviously the estate has monies that it can
4 use to fund its operations, and we're not here to tell you
5 that that shouldn't happen. What we're here to tell you is
6 that our property, the property that they receive and are to
7 remit to us need to be remitted to us, and not co-mingled,
8 and the monies that they've received that they have
9 converted, and not remitted to us as Judge Kimball found,
10 need to be escrowed until Judge Kimball is able to determine
11 the proper amount that is ours and the proper amount that is
12 the estate's. Your Honor, with that, that's really all we
13 wanted to say today. As I tried to point out, we are not
14 opposing the substantive relief. We're not trying to stop
15 the Debtor from continuing its operations. What we are
16 trying to make clear is we have rights here, we have property
17 that the Debtor has, and the Debtor receives. It's not the
18 Debtor's property to do with what they want, and we need
19 these orders to make that clear. Thank you, Your Honor.

20 THE COURT: Thank you. Mr. Spector.

21 MR. SPECTOR: At least two sides of every story,
22 Your Honor. And I expected we would hear that. And I
23 expected a relief from stay motion would be addressed as
24 well, and when it's filed we'll deal with it on the merits.
25 I don't want to belabor the Court with all the arguments to

1 the other side, I'll just hit on a few of them. The
2 transactions to which counsel was referring all occurred in
3 2003. The Debtor, SCO Operations, operated for the last four
4 years and used funds. And let me explain, very briefly, and
5 if the Court has any further questions about the litigation,
6 we have Mr. Singer here to address them. Very briefly, what
7 we're talking about is a contract in 1995 that counsel
8 referred to, called the APA, that the predecessor to SCO
9 bought a bundle of assets, and leave it to the lawyers that
10 litigated it to argue what those bundle of assets were. I've
11 read commentary that it's an extremely confusing document.
12 Nevertheless, SCO viewed the contract as giving them rights
13 that Novell has taken the opposite position. At the time of
14 the transactions in question in 2003, a lot of people, Novell
15 people read the contract the same way the SCO people read it.
16 That they had these rights. And based on their understanding
17 of the contract, they did a transaction with Sun, and they
18 did a transaction with Microsoft that yielded about 25
19 million or so in royalties. We come to litigation, and on
20 August 10th, 2007, we find out, Oh my God! A Federal judge
21 has agreed that, with Novell that we didn't really buy these
22 rights. Okay? That's the conversion. We're talking about a
23 dispute over the contract. The Judge was also asked by
24 Novell, in the 102 page, in the motions that led to the 102
25 page decision for a preliminary injunction barring SCO from

1 using the remaining cash. Judge - -

2 THE COURT: Kimball.

3 MR. SPECTOR: - - Kimball really threw a fast ball
4 at the head of SCO with the ruling. It was a very, very pro-
5 Novell, anti-SCO ruling. But one thing he did not do was to
6 grant the request for preliminary injunction. There is no
7 incumbrance on this money. There's been no constructive
8 trust declared on these funds. The argument - - let's be
9 very lawyer-like. The argument is of the 25 million or so
10 that we obtained in 2003, how much of that really relates to
11 this off limits-type software that you thought you owned, but
12 you didn't? Some of the stuff, of the 25 million was, by
13 even their count, legitimately earned by SCO. So the trial
14 was going to be to identify how much of the 25 million is,
15 arguably, tainted money that should have been turned over in
16 2003. Once that's decided, whatever that number is, 10
17 million, 15 million, then the next question is how much of
18 the money still in the hands of the Debtor is traceable to
19 those, quote, "tainted funds". That, Your Honor, is the core
20 of bankruptcy jurisdiction. What is and what is not property
21 of the estate. We think it's going to be this, this Court's
22 determination on that question when the rubber meets the
23 road. We would be happy to talk about structuring a lift
24 stay, a modification of stay motions with counsel outside the
25 presence of the Court. We look forward to that. We knew

1 this was coming. What we're prepared to say today, and then
2 I'll explain, is that of course, Novell can reserve all its
3 rights. Of course. We don't have a problem with that. But
4 we don't think they have a right to say that we can't use,
5 quote, "their money", when nothing has been declared finally
6 as their money. On top of that, Your Honor, with respect to
7 the 5% administrative fee, and the 95% royalty pay over to
8 Novell that's been going on since 1995, counsel said, without
9 hitch, what's the big deal? We're going to continue to pay
10 it pursuant to the contract. This was part of the contract
11 nobody had a dispute over, and we legitimately and properly
12 turned it over to them whenever it was earned per the
13 contract. They haven't complained about that. Why mess with
14 it now? We don't intend to not pay them what we're
15 contractually bound to pay, and we think it's an
16 administrative nightmare to try to identify this 95 and 5.
17 The contract doesn't require a segregation of those funds,
18 and it never was done. We don't think we should impose that
19 at this time.

20 THE COURT: Thank you Mr. Spector.

21 MR. NASHELSKY: Your Honor, if I may just briefly.
22 I'll take the second point first. You know, the world has
23 clearly changed. SCO has asked Your Honor for relief, or has
24 filed for relief and asked Your Honor to administer it's
25 case. The 95/5 needs to be administered in a way that

1 protects Novell's interest. SCO cannot just collect our
2 money, that there is no dispute is our property. Is not
3 property of the estate. They don't get the right to take our
4 property, co-mingle it, and then at the end of a quarter, or
5 whatever the time period it, hand it back to us and go,
6 Here's your property back. The Bankruptcy Code requires that
7 property of the estate that's theirs, they can use. Property
8 that's other party's, they can't use. And so we need to be
9 clear that we're not just going to wait until the end of a
10 quarter and hope that all that money that is our money, and
11 was never their money, still exists at the end to pay us. It
12 is not, it should not be an administrative nightmare. A
13 hundred percent of the royalties under those licenses are
14 ours. They deduct the 5% fee. They know what those monies
15 are. They've always turned them over. When those monies
16 come in, they need to be segregated in a bank account to be
17 turned over to us. Not co-mingled so that if the money
18 exists at the end of a period where it gets looked at if
19 there's enough left, we get ours back. It's a basic tenant
20 of Bankruptcy law, as Your Honor knows. The estate has
21 properties, property, the creditors have property, and the
22 estate is not allowed to us our property. On the, on the
23 first point, Your Honor - -

24 THE COURT: That no injunction was entered?

25 MR. NASHELSKY: Yeah. Thank you. There is, it is

1 not only conversion when a Court determines that it's
2 conversion. It's conversion when you do it. The Court found
3 that those funds were converted. On the constructive trust,
4 I'm not here to tell Your Honor that a constructive trust has
5 been established in a set amount, and that's been determined.
6 Clearly, that's not. That was the part of the preliminary
7 injunction that was denied, solely for the, for Judge Kimball
8 to determine how much of, of the Microsoft and Sun royalty
9 payments should be within the constructive trust and how much
10 were Novell's property. Not a question of whether it's
11 Novell's property, just the dollar amount. And what we're
12 asking Your Honor is to hold in escrow, or have the Debtor
13 hold in escrow those funds until that determination is made.
14 It is not a question of whether there's a constructive trust,
15 it's only a question of how much, as counsel has noted. And
16 we think, you know, there's nobody in a better position right
17 now, than Judge Kimball, who's had all these facts for all
18 this time, spent all the time with the parties and the
19 evidence, to make that determination in a 3-4 day trial that
20 he was ready to start yesterday. Thank you, Your Honor.

21 THE COURT: Thank you.

22 MR. SPECTOR: To bring us back to where we were,
23 Your Honor, I handed up the black line - -

24 THE COURT: Yes.

25 MR. SPECTOR: - - and an original.

1 THE COURT: Well, I certainly understand Novell's
2 position, and at the time that there's a hearing, and a, on
3 the motion, and evidence presented, certainly I will take
4 facts into consideration. But for purposes of today, on the
5 first day motion, to do what Novell has requested, I would
6 have to put into every order such as this that a Debtor
7 shouldn't convert, that the Debtor should escrow any funds
8 that it's holding for others, and it would really give
9 Novell, I think, priority treatment over other creditors who
10 may be in similar positions that the Court doesn't even know
11 about, and who are not before me today. So I'm going to
12 enter the order as presented.

13 MR. NASHELSKY: Your Honor, Your Honor, if I may?

14 THE COURT: And I certainly will hear Novell on
15 notice and, of a motion.

16 MR. NASHELSKY: Your Honor, there are two parts to
17 this, and maybe it would be easier if - - on the first part
18 where it's undisputed, and they agree it's ours, I would
19 think that, that it would be clear and easy for them to say
20 that those monies they collect which is ours, not the one
21 that's in dispute that Judge Kimball is going to decide as
22 part of the counter claims, but the monies they collected
23 over time, that are our monies that they take the fee for,
24 there really is no reason, that's not escrow it later, that's
25 not deal with it. It's our property that they're collecting.

1 They should be able to keep that segregated. That doesn't
2 effect any other creditor. It doesn't affect that, that,
3 that piece should be able to be kept separate in just the
4 cash management order that they collect those. They can, you
5 know, they can pay all the, the wages and things they have,
6 because they have a whole bundle of money today. But it's
7 the money that comes in that should be kept separate, not co-
8 mingled, and turned over to us, and then they can keep the 5%
9 fee from that. That really shouldn't implicate any of these
10 other things, or implicate any of the other motions, and
11 reserve rights through all the, the other orders. That
12 should be a discrete issue that protects Novell as to its
13 property. And I would ask if Your Honor could, could do
14 that. That's - - the Debtors concede it's not theirs. It
15 should not be an issue. This is not going to the money they
16 have at hand. It's the money they collect for us.

17 THE COURT: Mr. Spector.

18 MR. SPECTOR: Your Honor, we've already confirmed on
19 the record it's not an issue we're going to pay it. This
20 isn't a situation where this is going to be hidden. This is
21 a Chapter 11. Open kimono. They're going to see financials,
22 they're going to see the cash flow every month. If there
23 ever becomes a problem we' know we'll be back here. I don't
24 think we need to change the order in any way for this
25 particular issue.

1 THE COURT: Yeah, the, this order does not prejudice
2 Novell in any way. And I don't know that on this motion I
3 should be granting Novell in effect affirmative relief.
4 Which is what it's requesting this morning. And I'm going to
5 enter the order as it's been presented to me.

6 MR. SPECTOR: Thank you, Your Honor.

7 THE COURT: I understand Novell's position, and
8 certainly Novell has every right to bring whatever motion it
9 seeks, and the Court will certainly consider that motion at
10 the appropriate time.

11 MR. NASHELSKY: We will be back before Your Honor.

12 THE COURT: Thank you.

13 MR. NASHELSKY: With a motion.

14 THE COURT: Yes.

15 MR. SPECTOR: Your Honor, we turn to the wage
16 motion, which is also a fairly routine issue. And this is
17 going to be more routine than the usual one, because payroll
18 was made the day before bankruptcy. You know, in our zeal to
19 do a good job for our client, we drafted up the typical
20 motion for wage order, wage order allowing us to pay the pre-
21 petition wages and fringe benefits, and the like, but really
22 the issue is dissipated because of the wisdom of management.
23 So at this point, it's really reduced to a couple of issues
24 other than that. The company has about 123 employees today.

25 THE COURT: Yes.

1 MR. SPECTOR: But that's shortly going to be
2 shrinking in a significant amount. This company is going to
3 have to go through a reduction in force, and we'll be doing
4 that shortly. A motion regarding severance will be coming to
5 this Court on another date. It's one of the papers we filed,
6 but it's not for today.

7 THE COURT: Yes.

8 MR. SPECTOR: Our motion stated, again, and in belt
9 and suspenders fashion that we wanted permission to pay
10 severance for those people we were going to let go before the
11 bankruptcy. We didn't let anybody go before the bankruptcy.
12 So you'll see the line item for that is zero. The US Trustee
13 has asked us to just delete any reference to that, and I
14 believe the order we're about to hand up does exactly that.
15 So that was a sticking point I think we've taken care of.
16 There's another issue, and I want to compliment and applaud
17 Mr. McMahon for raising this issue, because I've never seen
18 it before, and I'm, I understand a lot of experienced hands
19 haven't as well. And that deals with the, the relationship
20 between 507(a) (4) and 507(a) (5). He's pointed out, and I
21 think appropriately under the statute, that those are, you
22 have to look at them together. Pre-petition wage claims for
23 180 days, including fringe benefits are priority up to the
24 tune of \$10,950 today, and as, (a) (4), and (a) (5) says and
25 also retirement benefits for the employee, that's 10,950,

1 less whatever you paid as a priority under (a)(4). I don't
2 remember ever seeing that raised, and I applaud him for
3 raising it. And I, it's easy for me to do, because it's not
4 a problem in this case, because we paid pre-petition wages up
5 to the date of the filing. So there's not going to be a
6 whole lot that's going to be covered under (a)(4). And I
7 assure the Court that we will not be busting the cap of the
8 two combined. I think I've covered the items that Mr.
9 McMahan has raised, but if I'm wrong I'll let him speak to
10 anything else.

11 THE COURT: Mr. McMahan.

12 MR. McMAHON: Your Honor, good morning again. With
13 the understanding that there's no retention or severance
14 authority being approved today, and also with the, with the
15 acknowledgment that the 507(a)(4) and (a)(5) cap will apply,
16 and I believe it's being inserted in the form of order,
17 counsel has addressed our concerns there.

18 THE COURT: Thank you, Mr. McMahan.

19 MR. SPECTOR: Unless - -

20 THE COURT: And I understand, I understand that
21 Novell's concerns went to this motion as well. And is that
22 correct?

23 MR. NASHELSKY: Correct, Your Honor. It's the use
24 of the funds. We don't have a problem with the Debtors' pre-
25 petition wages and how they're paying.

1 THE COURT: Thank you.

2 MR. SPECTOR: And we, we agreed whatever rights they
3 can reserve, it goes without saying, but I'll say it.

4 THE COURT: Exactly.

5 MR. SPECTOR: I'm handing up to Your Honor, with
6 your permission, a black line and the original.

7 THE COURT: Thank you.

8 MR. SPECTOR: Finally, Your Honor, we have this
9 unfortunate motion, which we didn't expect to have to bring,
10 but when, sometimes things happen you don't expect. And one
11 of, and that is we've had a rash of mid-level and lower-level
12 accounting personnel leave. Now that's bad enough anyway,
13 even in the, even in the throes of an intended reduction in
14 force. It's because we have a year-end coming October 31st.
15 This is a public company, there's quite a lot of accounting
16 work that has to be done to prepare the proper regulatory
17 filings and the, and the like. And so the company is at a
18 crucial stage that it needs to get people, bodies behind the
19 desk to do the work. So the company, well, this would
20 normally be an ordinary course situation we wouldn't bring to
21 Your Honor, but - - they'd just go out and hire new people.
22 But they can't hire new people in that kind of a hurry. They
23 have to go to an accounting - - strike that. A - -

24 THE COURT: A temporary - -

25 MR. SPECTOR: - - a temporary agency.

1 THE COURT: Accountemps.

2 MR. SPECTOR: Accountemps. And get, and do it that
3 way. And I inquired of the client, and they didn't usually
4 do this. And I said, Well, haven't you done this? No, we
5 haven't. Well, I said, well in the utmost of caution, belt
6 and suspenders fashion, we'll come and bring this before Your
7 Honor, and get this approved formally. And that's what this
8 motion is about. You know, Mr. McMahon, on behalf of the US
9 Trustee had legitimate concerns about are we hiring the CFO
10 or other higher paid employees, and the answer to that, after
11 consultation with the client, is no. These are line
12 employees, non-management. He wanted that assurance, and if
13 he wants the names of the people being replaced, I'm not sure
14 if we've gotten to that level, but I suppose it can be
15 gotten, we just don't have it this early this morning.

16 THE COURT: Understood. Mr. O'Neill, good morning.

17 MR. O'NEILL: Good morning, Your Honor.

18 THE COURT: Good morning.

19 MR. O'NEILL: James O'Neill. I just wanted to
20 provide a little additional information on this. I've been
21 working with Mr. McMahon, and we're, what we'd like to do
22 with respect to this motion is file the order under
23 certification of counsel. Mr. McMahon has provided comments
24 to our form of order today addressing his concern, and we
25 will be modifying the order to indicate that we are hiring

1 non-officer temporary account employees, accounting employees
2 subject to a cap of \$20 thousand through October 31st. The
3 Debtor will have continuing needs for hiring employees on a
4 temporary basis, so with the, with respect to the balance of
5 the relief requested, we would seek to put that relief out on
6 notice to give us more time to talk with the United States
7 Trustee to give them additional information. Then we'll come
8 back for the balance of the relief. But in the interim, as
9 Mr. Spector suggested, because we have the end of the fiscal
10 year coming up, we do need this relief. So we'll submit this
11 order under certification of counsel.

12 THE COURT: Thank you. And I will obviously look at
13 it, and I'm sure it will be appropriate, and enter it
14 promptly today.

15 MR. O'NEILL: Thank you very much.

16 THE COURT: If it's over here today. Ms. Jones.

17 MS. DAVIS JONES: Your Honor, a couple other motions
18 left to do. Matter of, the next matter, Your Honor, was our
19 motion with respect to authority to pay sales and use taxes
20 in the ordinary course. Your Honor, we did ask that we be
21 able to pay over sales taxes up to a cap of 54 thousand and
22 franchise taxes up a cap of \$9,300. As they come due, we'll
23 send them over to the appropriate taxing authority with this
24 Court's permission. Your Honor, I don't think Mr. McMahon
25 had any issues with respect to that, and we'd ask that that

1 be approved.

2 THE COURT: Thank you. Yes. I'll approve that.

3 MS. DAVIS JONES: May I approach - -

4 THE COURT: You may.

5 MS. DAVIS JONES: - - Your Honor?

6 THE COURT: You may. Thank you. Okay.

7 MS. DAVIS JONES: Your Honor, the last motion I
8 would address is that in connection with utilities. Your
9 Honor, we only have three utilities that we addressed in the
10 motion, and we're seeking an interim order. And Your Honor,
11 the, the, on an average monthly basis, the utilities run
12 about \$10 thousand. And what we're seeking to do within ten
13 days from now is to pay 50% of a one month average run rate,
14 so about \$6 thousand in total, of deposits to the utilities.
15 Your Honor, usually given this few of utilities we wouldn't
16 bring the matter before the Court, but Your Honor, since the
17 new Code changes in 2005 it really puts the Debtor in a
18 difficult position, because the, a utility could demand
19 whatever amount of money, and if the Debtor did not consent
20 then the lights could be turned out. So Your Honor, what
21 we've done, and what seems to work in the various cases, is
22 to provide that we will pay this deposit within ten days, and
23 Your Honor it does set up a protocol. We haven't limited
24 when a utility can make an adequate assurance demand, just
25 that they can make one.

1 THE COURT: Yes.

2 MS. DAVIS JONES: And if they do, Your Honor, I
3 believe we have 30 days to work it out, or bring it before
4 the Court. So Your Honor, we'd ask that that motion be
5 approved as well, and I don't think Mr. McMahon had any
6 issues with respect to that.

7 THE COURT: Very well. And I have approved similar
8 orders, and I will approve this one as well.

9 MS. DAVIS JONES: May I approach, Your Honor?

10 THE COURT: Yes. Thank you. Mr. Spector, yes, sir.

11 MR. SPECTOR: Your Honor, with that I'd like to move
12 the admission of the first day affidavit of Mr. McBride into
13 evidence.

14 THE COURT: Any objection? It is admitted.

15 MR. SPECTOR: Thank you.

16 THE COURT: Thank you.

17 MS. DAVIS JONES: Your Honor, two of the proposed
18 orders that we submitted to the Court had scheduling blanks
19 in them. Specifically Your Honor, the - -

20 THE COURT: Yes.

21 MS. DAVIS JONES: - - bank accounts with respect to
22 the 345.

23 THE COURT: Yes.

24 MS. DAVIS JONES: And also on the wages, Your Honor,
25 the incentive and the severance issues.

1 THE COURT: Tell me what you had in mind for those.

2 MS. DAVIS JONES: Your Honor, I think in terms of
3 being able to get those out on notice and come back before
4 the Court, and also Your Honor, we'd ask that we'd be able to
5 put the retention applications and the other matters that we
6 didn't have heard today but that are file also scheduled at
7 the second hearing, if we may.

8 THE COURT: Yes.

9 MS. DAVIS JONES: Your Honor, it seems like
10 something in the week of October 8 seems to be the right
11 period of time. Let me check the dates here. Your Honor, I
12 am, I am very familiar with the concept that the NCBJ is
13 during the week, starts on the 10th of October. So - -

14 THE COURT: But I won't be attending that this year.
15 So I'll be here.

16 MS. DAVIS JONES: Okay.

17 THE COURT: I don't know - -

18 MR. SPECTOR: I'll be there.

19 THE COURT: That could - -

20 MR. SPECTOR: I'm one of the hosts.

21 THE COURT: Oh, so that's a problem. That week is a
22 problem is what you're telling me.

23 MS. DAVIS JONES: Yeah, Your Honor, I didn't know if
24 we, if anything like maybe October 5 or possible October 8.
25 Oh, October 8's a holiday. I take that back.

1 MR. SPECTOR: It's Columbus Day, I think.

2 MS. DAVIS JONES: It is. So Your Honor, maybe - -

3 THE COURT: October 5 works. In the - -

4 MS. DAVIS JONES: If that's sufficient for Your
5 Honor. Your Honor, that would make the next hearing
6 approximately 18 days from now, as compared to the, typically
7 the 20 days. But I still think that provides sufficient time
8 - -

9 THE COURT: And otherwise we'll go out a little bit
10 too far, I think. Let's do it, I do have the morning tied
11 up. We we could do this at 1:30 on the 5th. Friday the 5th.

12 MS. DAVIS JONES: That's fine, Your Honor.

13 THE COURT: It will allow Mr. Spector or others to
14 travel, to travel more easily.

15 MR. SPECTOR: That's excellent. Thank you, Your
16 Honor.

17 THE COURT: 1:30, SCO.

18 MR. SPECTOR: Oh, oh, oh. Just a minute. I just
19 realized something. That's October 5th, Friday.

20 THE COURT: Yes.

21 MR. SPECTOR: I'm in my nephew's wedding in Denver,
22 Colorado that weekend.

23 THE COURT: Okay.

24 MR. SPECTOR: And that Friday is - - I have to put
25 this in my calendar. I can't just remember.

1 THE COURT: Let's see.

2 MR. SPECTOR: Unless this Court has divorce
3 authority.

4 THE COURT: No. No I don't.

5 MR. SPECTOR: Your Honor, I might ask Mr. Singerman,
6 who's hopefully still on the phone, whether he could cover
7 that hearing so we don't have to put everybody at my nephew's
8 disposal.

9 THE COURT: Mr. Singerman, how do you look on
10 October 5th?

11 MR. SINGERMAN(Telephonic): Your Honor, I am pleased
12 to report it will be a perfect excuse to cancel a medical
13 appointment, and I would be honored to be before you.

14 THE COURT: All right. Well, you may have problems
15 with your wife, cancelling a medical appointment. But I'm
16 sure it will work. 1:30 p.m.

17 MR. SINGERMAN(Telephonic): Thank you, Your Honor.

18 THE COURT: October 5th.

19 MS. DAVIS JONES: Your Honor, there are actually
20 three matters that I think that the date is implicated in.
21 The third one, Your Honor, is the utilities.

22 THE COURT: Yes. And as far as the objection
23 deadline is concerned, October 2nd, I'll make it October 2nd at
24 4 p.m.

25 MS. DAVIS JONES: Thank you, Your Honor.

1 THE COURT: And you'll notice the retention motions
2 applications for that same date.

3 MS. DAVIS JONES: Yes, sir.

4 THE COURT: All right. Is there anything further?

5 MS. DAVIS JONES: No, there isn't, Your Honor. And
6 thank you again for making time this morning.

7 THE COURT: Thank you everyone, and we'll stand in
8 recess.

9 MR. SINGERMAN (Telephonic): Thank you, Your Honor.

10 THE COURT: Thank you.

11 MR. SPECTOR: Thank you, Your Honor.

12 (Whereupon at 9:27 a.m. the hearing in this matter was
13 concluded for this date.)

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16

17

18 I, Jennifer Ryan Enslin, approved transcriber for
19 the United States Courts, certify that the foregoing is a
20 correct transcript from the electronic sound recording of the
21 proceedings in the above entitled matter.

22

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09/24/07