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

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| In re: | ) | |
| | ) | Chapter 11 |
| The SCO Group, Inc., et al., | ) | |
| | ) | Case No. 07-11337 (KG) |
| Debtors. | ) | (Jointly Administered) |

**Objection Deadline: , July 20, 2009 at 2:30 p.m. (prevailing Eastern time)**
**Hearing: July 27, 2009 at 9:00 a.m. (prevailing Eastern time)**

**NOVELL'S OPPOSITION TO THE DEBTORS'**
**MOTION FOR AUTHORITY TO SELL**

Novell[1] hereby objects to the Debtors' Motion to Sell Property Outside the Ordinary Course of Business [etc.] (dated and filed June 22, 2009) (the "Third Sale Motion").

By the Third Sale Motion, debtors and debtors in possession The SCO Group, Inc. and SCO Operations, Inc. (together, the "Debtors") nominally seek authority to sell assets to a newly-formed entity called Unxis, Inc. ("Unxis"). However, the real objective of the transaction is a last-gasp attempt by the Debtors to retain control of litigation (the "Litigation") against Novell, International Business Machines Corporation ("IBM") and others that the Debtors believe will be their big payday. Having already hijacked the chapter 11 process for almost two years to serve that objective, which crowded out all other concerns, on June 15 the Debtors faced three motions to convert the cases to chapter 7 (the "Conversion Motions") because of their repeated missteps and continuing financial hemorrhaging. To meet this threat to their dream of a home run in the Litigation, the Debtors once again manufactured a gambit in the form of the Third Sale Motion seeking approval of the Purchase and Sale Agreement (the "PSA") with Unxis. Given the PSA's genesis, it should not surprise the Court that there are numerous problems with the transaction because its purpose, like virtually everything else the Debtors have

[1] Terms not defined herein will have the meanings ascribed to them in Novell's Motion for Conversion (Dkit. 753).

done in these cases over the past 22 months, is not to serve the interests of the creditors, but those of the Debtors' officers and Board (the "Management"). It both has inherent problems and would leave the cases and creditor interests in total confusion and uncertainty. Indeed, when viewed in light of the history of these cases as well as its own terms, the PSA fails any applicable test for approval of a sale out of the ordinary course of business. Hence, Novell submits, the Court should deny the Third Sale Motion and instead grant the Conversion Motions – to which the PSA effectively is the Debtors' "answer".

## I. PROLOGUE

1. The provenance of the Third Sale Motion is important to its resolution. That is because this is not an ordinary sale-out-of-the-ordinary-course motion. It is an attempt to have obtained the benefits of the protections of chapter 11 to serve the visions of Management without regard to the interests of their creditors. A short history follows here that is a distillation of the factual background set out at length in the Conversion Motions filed by Novell, IBM and the United States Trustee (the "UST") (*see* Dkt. Nos. 750, 751, 753), updated with recent events.

2. In August of 2007, in the part of the Litigation against Novell (the "District Court Action"), the District Court held that the Asset Purchase Agreement (the "APA") between Novell and The Santa Cruz Operations, Inc. ("Santa Cruz"), the Debtors' predecessor, did not transfer certain UNIX copyrights from Novell to Santa Cruz.[2] These copyrights are at the core of the Debtor's business plan of using UNIX copyright infringement claims to try to force other parties to license the copyrights from the Debtors.

3. In September of 2007, the Debtors filed these cases the business day before trial in the District Court Action on the few remaining issues, which related principally to damages. Ultimately, over the Debtors' objections, Novell obtained stay relief to complete the trial. The

[2] A useful description of the District Court Action can be found at pages 8-13 of Novell's reply to the Debtors' opposition to the Conversion Motions, Dkt. No. 796.

District Court entered judgment for Novell, including money judgment for over $3.5 million. Of that figure, about $650,000 the Debtors now hold in trust for Novell.

4. In May of this year, twenty months and effectively four exclusivity extensions later, Novell, IBM and the UST filed the Conversion Motions. As the moving parties pointed out at great length, as disclosed in their own monthly operating reports, the Debtors had wasted time and millions of dollars on historically unprofitable business operations, repeated ill-advised, incompletely-documented and even illusory proposed sales and reorganization plans, and on related proceedings (such as the York Compensation Motion and the SNCP Compensation Motion) that served no legitimate purpose. This history belies the Debtors' claim (*see* Third Sale Motion 2) that their failures were a matter their own diligence frustrated only by uncertainty about what key assets they owned to sell.

5. Worse yet, as the particulars of the PSA again reflect, all of this wasted time, effort and resources were in the service of Management's frantic bid to hang onto the Litigation because they think the Litigation is their ticket to untold riches. They have pursued this goal without regard to the interests of creditors (or even shareholders). The effect on creditors has been grim. By the time of the Conversion Motions, is it was clear that creditors would fare far worse than they would have at the beginning of the cases. The Debtors have lost millions of dollars trying to maintain the appearance of a going concern in order to remain as debtors in possession in control of the Litigation.

6. Facing substantial grounds for conversion, the Debtors have another last minute gambit. On the day, and indeed, at the very hour of, the hearing, they walked into Court with yet another "sale" (their third proposed sale during the cases) that they claimed they had literally just signed. They requested that the Court consider the PSA the day before it ruled on the Conversion Motions. (Transcript of June 15, 2009 Hearing ("6/15 Tr.") 9:6-8; *see also* 8:1-4 (PSA signed ten minutes before 2 p.m. hearing).) They brought with them the PSA, but not its crucial schedules and exhibits. The *only* reason that Debtors didn't have those papers, they said, was that they were still copying them, one being over 500 pages. Assuring the Court that the

PSA was final and complete and that the incomplete status of the PSA was not a sign that there was no real agreement, the Debtors told the Court and parties that the exhibits and schedules would be ready shortly, perhaps even before the hearing concluded. Indeed, the Debtors said, they copies should be available in "[m]inutes." (6/15 Tr. 9:24-10:3.) It bears quoting the Debtors' representations to the Court and parties that day:

> MR. SPECTOR: But everything is now signed, sealed and delivered. All the schedules, all the exhibits, all that's together. It only just happened as I was walking over to Court.

(6/15 Tr. 9:11-14.) The Debtors later added:

> MR. SPECTOR: . . . [A]nd by the way, those schedules are still being copied. One exhibit alone I found out was 500 pages. That has to be delivered too as part of the contract.

(6/15 Tr. 17:24-18:1; *see also* 7:23-8:4 (document "still being copied" because it had just been signed and was "enormous").)

7. The Debtors then set the context for the role of the PSA in this Case, although none of this appears in the Third Sale Motion itself, so it is unknown to creditors other than those who attended the June 15 hearing since the Debtors do not raise the subject in the Third Sale Motion:

> What we plan to do with Your Honor's blessing, close the sale, dismiss the case, pay the creditors in full, get no discharge of any Novell claim. We have a bond set aside to fully pay Novell. We're wondering if they may have missed that. They should be in favor of that. We have a bond set aside as part of this deal to pay Novell in full. IBM, we'll meet them in Court, no discharge, get out of bankruptcy with a dismissal, pay the creditors upon exit and go on our merry way.

(6/15 Tr. at 28:22-29:5.) As Novell will detail presently, none of these representations about the state of the PSA and its attachments or what the PSA supposedly accomplishes have panned out. Once again, it was a case of the Debtors overselling what they had on offer in order to forestall an adverse (for Management) result.

8. Over the objections of IBM and Novell, the Court agreed to consider the PSA in connection with the Conversion Motions. The Court reached this result based upon its finding

that the Debtors were proceeding in good faith, a conclusion it reached in reliance on the Debtors' representations and some testimony from the Debtors. Given the lateness of the hour and the moving parties' clear disadvantage in trying to deal with the PSA on essentially no notice at all, the Court and parties adjourned the Conversion Motions to be heard with a motion by the Debtors for approval of the PSA on a schedule the parties were to agree upon. The parties thereafter agreed that the Debtors would file the sale motion by June 22, with oppositions due by July 20 after discovery, and a joint hearing on the sale motion and Conversion Motions on July 27.

9. In fact, the Debtors did not file the Third Sale Motion until late at night on June 22. (Dkt. 815.) Furthermore, they still did not attach the schedules or exhibits. Most of those came only on June 23rd even though the Debtors had represented to the Court on June 15 that the schedules and exhibits were ready, only awaiting completion of copying. (Dkt. 819.)[3] Finally, a key exhibit, Exhibit A listing the executory contracts to be assumed and assigned (an exhibit that, like the others, supposedly was ready to go and final on June 15) was not filed until July 10, 18 days after the agreed-upon deadline and 25 days after the June 15 hearing, when the Debtors represented to this Court unequivocally that it was complete except for copying. (Dkt. Nos. 832, 833.) Even then, it took the Debtors yet another week and repeated inquiries by Novell before the Debtors could state positively whether the crucial Novell-Santa Cruz APA that is at the heart of the Litigation was to be assumed or not (it was not). (*See* Exhibit A hereto (email chain between counsel for the Debtors and Novell).)[4] Since the Debtors had represented on June 15 that they had taken so long to make a deal because they had only just worked out the key issue of what assets they claimed under the APA that they would need to keep (*see*, e.g., 6/15 Tr. 4:4-

[3] In keeping with the Debtors' utter disregard for procedure, a habit the Debtors always justify by claiming that such irregularity necessarily is the nature of bankruptcy, the Debtors' late (and incomplete) filing of the schedules and exhibits violated their agreement with IBM and Novell.

[4] Hence, this late filing not only broke the parties' agreement for the filing schedule for the Third Sale Motion, but also means that, in essence, the Debtors have not given Novell the minimum 15 days' notice for what amounts to a motion to assume. *See* Local Bankruptcy Rule 9006-1.

41:5), it is puzzling why the Debtors had to were so unclear on that subject that they could not respond definitively to Novell's questions until July 17, more than a month later.

10. Why this discussion of the background of the Third Sale Motion before we turn to the motion itself? This background, along with evidence that Novell believes will emerge at the hearing, establishes that the Debtor made this last-minute deal with Unxis, with which it allegedly had been negotiating for months, not for a sound business reason, but in a headlong and heedless attempt to avoid conversion and loss of control of the Litigation.

11. Novell now turns to the Third Sale Motion itself.

## II. THE THIRD SALE MOTION

### A. Relevant Basic Terms

12. In the Third Sale Motion, the Debtors ask the Court to approve a sale to Unxis of essentially all of the Debtors' assets except for its so-called "Mobility" business, the Litigation and such assets as are supposedly necessary for SCO to prosecute the Litigation, with the lattermost assets transferring to Unxis eventually, as well. The Debtors claim that the PSA meets the business judgment test for a sale out of the ordinary course.

13. According to the Debtors, the sale price is $5.25 million. It consists of a $250,000 cash deposit to be paid upon closing, a $2.15 million letter of credit to be drawn upon closing, and a $2.85 million letter of credit to be drawn by the Debtors to "contribute to" the payment of any final judgment Novell gets, subject to certain very important conditions that Novell will discuss presently. (*See* PSA, Article 1.1, (definitions of "Letter of Credit – Balance", "Letter of Credit – Sun"; Article III.)[5]

[5] The Court should also decline to grant the Debtors' request to waive the requirements of Bankruptcy Rule 6004(h). (Third Sale Motion 15-16.) The Debtor gives no reason why the waiting period should be waived, and given that the parties have at least 90 days to close the if and when the PSA is approved, there is no discernible reason for the Court to do so. (*See* PSA, Article 1.1 (definition of "Termination Date"), Article 4.1.)

### B. Analysis of the Terms and Effect of the PSA

14. The PSA represents some good news and lots of bad news, with much of the latter requiring some digging.

15. The good news is that the Debtors are getting some money and unloading some of their money-losing operations in the process. There is no other good news.

16. The bad news is rather more prolific. First, it is not at all clear that the consideration the Debtors are getting in the PSA is fair or reasonable given their haste to create *some* transaction before the Court considered the Conversion Motions. The eleventh-hour (actually, eleventh hour and 50-minute) arrival of the PSA makes the price suspect in principle. Perhaps they could have gotten even more money for what they are selling, however unprofitable a business it has been in *their* hands, had they not been at Unxis's mercy at 1:50 p.m. on June 15.

17. Second, although the Debtors are disposing of a portion of their losing operations, they are not disposing of all of them. They are keeping a portion of the Mobility business that also has lost money since its inception and is, by all indications of its multi-year history, destined to continue to lose money. If this is because Unxis did not want such a poor business, that cannot be helped beyond shutting that remaining operation down (which will doubtless take the grant of the Conversion Motions to accomplish because Management will never do that). However, if it is because the Debtors stubbornly refuse to sell that business segment even though Unxis or another bidder might buy and pay money for it, the PSA without a sale of the Mobility business is not an exercise of business judgment, but the persistent indulgence of illusion among Management.

18. Third, the alleged protection for Novell's ability to recover on a judgment against the Debtors in the form of the Letter of Credit – Sun (the "Novell LC") is to a very real extent illusory (and, therefore, along with it, the alleged $5.25 million sale price). First, the $2.85 million Novell LC already falls far short of the current judgment in the District Court Action – over $3.5 million. In this regard, the PSA expressly says that Unxis will not be liable

for any excess of a final judgment for Novell over the amount of the Novell LC. (PSA, Article 3.3(c)(iii).) This fact conflicts directly with the representation by the Debtors at the June 15 hearing quoted above: that the PSA will assure Novell of 100% payment.[6] This representation is all the more disturbing if, as the Debtors claimed on June 15, the PSA was in final form.

19. But it gets worse. The Novell LC evaporates on December 31, 2009 if not drawn by then, with Unxis completely relieved of any obligation to pay or contribute to any judgment for Novell. (PSA, Article .3(c)(iv).). This might happen if the Tenth Circuit does not rule on the Debtors' appeal of the District Court Action by then or reverses and remands for further proceedings that do not result in an enforceable judgment by then. As with the inadequate amount of the Novell LC just discussed, this expiration term in the PSA again means that the Debtors' representation to the Court that the PSA assures Novell of 100% payment was and is false.

20. Note also that there is no provision for payment of IBM and other counterparties to the Litigation.

21. Fourth, another troubling hidden gem in the PSA, mentioned only obliquely in the Third Sale Motion, is the poison pill in Article 12.4(a)(iv). It provides that the Litigation and related assets transfer to Unxis if the Court enters a pre-confirmation order converting the case to chapter 7, appointing a chapter 11 trustee or appointing an examiner. It is hard to conceive what possible interest of the creditors this provision serves. It may be even worse than that: it may be that the Debtors are trying to discourage the Court's discretion and ability to protect creditors. If these assets, including the Debtors' alleged claims against Novell, have any value (which, once again, is something Novell believes a trustee, not Management, should assess), such a penalty for creditors and imposition on the Court's discretion is unthinkable. In any event, this plainly is not the exercise of sound business judgment. Notably, too, this "detail" is not something that the

[6] Curiously, the Debtors fail to schedule the amount of Novell's judgment, even as disputed, on the amended to their Schedule F that they just filed on July 1, 2009 (Dkt. No. 824). Presumably, they think that it did not need to be scheduled because the judgment is on appeal. One wonders what other disputed, contingent or unliquidated claims Debtors have not scheduled (other than, e.g., IBM's) for similar reasons.

Debtors should have buried in the Third Sale Motion under the vagary that "[t]hese rights [the retained Litigation claims and related assets] become vested in the Purchaser upon the occurrence of certain events . . . ." (Third Sale Motion at 5.)

22. Fifth, the Third Sale Motion leaves these chapter 11 cases in limbo, if not in extremis, whether they continue or, as the Debtors said they on June 15 planned to request, are dismissed. There is no plan on the horizon. The Debtors lack funds to pay creditors in full, yet they evidently propose to continue their regrettable and disastrous model of pursuing the Litigation and their money-losing business (albeit stripped down to the Mobility segment) that has characterized their every moment in chapter 11. When the Debtors finish spending money on the Litigation and losing money on Mobility, there will be still less money to pay even those creditors Debtors now acknowledge, let alone those Debtors choose to ignore such as IBM. In essence all that will have happened as a result of these chapter 11 cases is that the Debtors will have gotten themselves for free (but at a tremendously high price for Creditors) a two-year stay pending appeal in the District Court Action to serve their narrow objective of retaining control of the Litigation.

23. What business purpose, therefore, does the PSA sale serve? The answer is, "None." Rather, it serves only to keep the Debtor's management in control of the Litigation for at least a little longer. This scheme is nothing more than an extension of the speculation at the creditors' expense that has defined these cases since they were filed two years ago.

24. There are other serious problems with the Third Sale Motion that are tied to the Debtors' plans for assuming and assigning contracts as those plans affect Novell. Novell will deal with those issues separately in its response to that aspect of the motion due July 22.

## III. THE THIRD SALE MOTION AND APA DO NOT MEET THE STANDARDS FOR A SALE OUT OF THE ORDINARY COURSE

25. The Third Sale Motion seeks the Court's approval for the PSA as a sale out of the ordinary course under Bankruptcy Code section 363(b)(1). A sale out the ordinary course requires

> [p]roof [by the Debtors] that: (1) there is a sound business purpose for the sale; (2) the proposed sale price is fair; (3) the debtor has provided adequate and reasonable notice; and (4) the buyer has acted in good faith. *In re Delaware & Hudson Railway Co.*, 124 B.R. 169, 176 (D. Del. 1991).

26. *In re Exaeris, Inc.*, 380 B.R. 741, 744 (Bankr. D. Del. 2008); *accord The Dai-Ichi Kangyo Bank, Ltd. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 242 B.R. 147, 153 (D. Del. 1999) (debtor must show that "sound business purpose justifies such actions"). The Debtors have the burden of proof on these issues. *Montgomery Ward*, 242 B.R. at 155.

27. Although all the evidence is not in because there will be testimony at the hearing of this matter,[7] there already is ample evidence that the Debtors have not satisfied at least the first three *Exaeris* factors: sound business judgment, fair price and adequacy of notice. On the fourth, good faith of the buyer, the record is yet to be made.

28. *Sound Business Purpose*. That the Debtors lack a sound business purpose justifying the proposed sale is obvious even before the introduction of further evidence at the July 27 hearing on the Third Sale Motion. For example,

- The sudden appearance of the PSA at the June 15 hearing on the Conversion Motions, the false characterization of the PSA as complete at that hearing, and the misrepresentations by the Debtors at the hearing and in the Third Sale Motion of what the sale would accomplish alone establish that the sale is the product of a last-ditch effort by the Debtors to control the Litigation and defeat the Conversions rather than careful, thoughtful and systematic negotiations.
- The poison pill provisions of the PSA reflect a personal rather than a business purpose of Management.
- The unexplained retention of the Mobility business indicates the lack of a realistic assessment of the financial impact of that operation.

[7] They may also be evidence from the discovery that Novell understands IBM has been conducting, reference to some of which may even appear in IBM's response to the Third Sale Motion.

- The utter failure of the Debtors to fit the proposed sale into some kind of rational plan for the protection of creditors going forward whether the cases remain on file or are dismissed demonstrates a focus only on retaining the Litigation.

29. *Fair Price*. The question of price remains unsettled, at best, given the obvious fact that the Debtors negotiated from desperation and the questions about why the Mobility business was not sold.

30. *Adequate Notice*. Finally, there are serious questions about the adequacy of notice. If the Debtors intend to dismiss the cases after completing the proposed sale, they should have explained that in the Third Sale Motion, especially to the creditors who did not attend the June 15 hearing on the conversion motions. And, furthermore, regardless of whether they intend to ask the Court to dismiss the cases, the Debtors should have provided substantial financial information about the impact of the proposed sale on creditors, including substantiated projections of debts to be paid and the results of future operations. Finally, the notice was inadequate for Novell because of the Debtors' failure to make clear the fate of the Novell-Santa Cruz APA until July 17.

## IV. CONCLUSION

The Third Sale Motion is of a piece with everything else the Debtors have done in these cases for two years. It is before this Court as just the latest in the Debtors' record of trying to bend these chapter 11 cases to their private will and dreams rather than to serve the interests of all concerned, creditors most of all. Novell submits the Court should deny the Third Sale Motion and grant the Conversion Motions, whose rationale has grown even stronger in light of the problems with the Third Sale Motion and PSA.[8]

[8] If any issues on assumption and assignment of executory contracts with Novell can be worked out, Novell might not object to approval of the PSA modified to address some of its concerns expressed above and with appropriate assurances that if and when the retained asset transfer to Unxis, Unxis and its successors are bound by the outcome of the District Court Action and other Litigation.

Dated: July 20, 2009
Wilmington, Delaware

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