

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE

In re: ) Chapter 11  
)  
The SCO GROUP, INC., et al.,<sup>1</sup> ) Case No. 07-11337 (KG)  
) (Jointly Administered)  
Debtors. )

Hearing Date: April 2, 2008 at 2:00 p.m. prevailing Eastern time  
Objection Deadline: March 26, 2008 at 4:00 p.m. prevailing Eastern time

**DEBTORS' MOTION TO APPROVE SETTLEMENT COMPENSATION OR  
SALE COMPENSATION AND EXPENSE REIMBURSEMENT TO PLAN SPONSOR**

The SCO Group, Inc. ("SCO") and SCO Operations, Inc. ("Operations") (SCO and Operations, collectively, the "Debtors") seek the approval of certain protections to Stephen Norris Capital Partners, LLC ("SNCP") on the terms provided in the Memorandum of Understanding ("MOU") attached as **Exhibit A** hereto, in consideration for SNCP's commitment to finance the *Debtors' Joint Plan of Reorganization* (the "Plan"), and pursuant to the definitive agreements contemplated thereby (the "Definitive Documents"). The Debtors will file the Plan and related Disclosure Statement by February 29, 2008, and seek a hearing on this Motion at the same time as the hearing to approve the Disclosure Statement. The Debtors will file the forms of the Definitive Documents (including those to be executed at the Effective Date of the Plan), at least 5 business days before the hearing on approval of the Disclosure Statement. In support of this motion (the "Motion"), the Debtors state:

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<sup>1</sup> The Debtors and the last four digits of each of the Debtors' federal tax identification numbers are as follows: (a) The SCO Group, Inc., a Delaware corporation, Fed. Tax Id. #2823; and (b) SCO Operations, Inc., a Delaware corporation, Fed. Tax ID. #7393.

## **Jurisdiction and Background**

1. This Court has jurisdiction over these cases pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).
2. The statutory predicates for the relief sought herein include: 11 U.S.C. §§ 105(a), 363(b), 364 and 503, implemented by Rules 2002(a)(2), 3017, 4001, 6004 and 9014 of the Federal Rules of Bankruptcy Procedure.
3. On September 14, 2007, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532.
4. For greater detail regarding the background of the Debtors' business and events leading up to the filing of these cases, the Debtors refer the Court and parties to the *Declaration of Darl C. McBride, Chief Executive Officer of the Debtors, in Support of First Day Motions* (the "McBride Declaration") (Docket No. 3) filed on the Petition Date and incorporated herein.
5. Within no more than 15 days of the filing of this Motion, the Debtors will file the Plan and *Disclosure Statement in Connection with Debtors' Joint Plan of Reorganization* (the "Disclosure Statement"). On February 13, 2008, in contemplation of the Plan, the Debtors executed the MOU with SNCP. A copy of the MOU is attached as **Exhibit A**.
6. The MOU commits SNCP to finance up to \$100 million for a plan of reorganization that provides for, among other things:
  - (a) payment in full of all creditors, including all trade and other unsecured creditors and the contingent, unliquidated and disputed claims of Novell and IBM, each on the earlier of the effective date of the Plan or the date when such claim becomes an allowed claim;

- (b) extinguishment of the existing equity securities (including common stock equivalents) of SCO;
- (c) On the Effective Date of the Plan, SNCP to pay \$5,000,000 (in cash or via wire transfer) to the reorganized SCO in consideration of a new class of preferred stock to be issued by SCO (“Series A Preferred”) which shall have the liquidation, voting and distribution preferences described in the MOU. At its option, the holder of the Series A Preferred will be able to convert the Series A Preferred into between 51% and 85% of SCO’s equity, depending on the amount drawn under the Debt Financing as defined and described below;
- (d) The reorganized Debtors to retain all of their intellectual property and all of their pending litigation rights and claims, including without limitation the potential liability or recoveries under the pending cases titled *The SCO Group, Inc. v. Novell, Inc.*, pending in the United States District Court for the District of Utah, Civil No. 2:04 CV-00139, and the related pending litigation, *The SCO Group, Inc. v. International Business Machines*, pending in the United States District Court for the District of Utah, Case No. 2:03CV0294DAK (the “Novell/IBM Litigation”). The MOU provides that the reorganized SCO will pursue the Novell/IBM Litigation and other pending litigation claims aggressively;
- (e) SNCP to also provide reorganized SCO with financing up to US \$95 million (the “Debt Financing”), available for, among other purposes, supporting appellate bonds (and, although SCO expects to prevail in the pending litigation claims, providing for full payment of allowed claims, if so required by final judgment adverse to reorganized SCO) in the Novell/IBM Litigation and other pending litigation claims. The Debt Financing will provide a five year non-revolving credit line and bear a high but appropriate rate of return (LIBOR plus 17%), reflecting the risks of this investment commitment and an commensurate rate of return. The Debt Financing shall be secured by all of the assets of SCO, including all of its present and future litigation claims;
- (f) The conversion percentage of the Series A Preferred to vary depending on the amount drawn on the facility after the Novell/IBM litigation claims resolve. Should the amount drawn be \$0, then the Series A Preferred will convert into 51% of reorganized SCO’s equity. Should the amount drawn be \$30 million or more, then the Series A Preferred will convert into 85% of reorganized SCO’s equity. Should the amount drawn be between \$0 and \$30 million, then the Series A Preferred will

convert into a percentage of the then-outstanding common stock of SCO proportionally;

- (g) Equity holders (and holders of common stock equivalents, including stock options) of SCO existing as of confirmation of the Plan to receive a pro-rata interest in a grantor trust (the "Trust"). The Trust shall be the holder of the new common stock (and new common stock equivalents) of SCO ("New Common Stock"), representing between 49% and 15% of SCO's fully diluted equity after conversion of the Series A Preferred, the precise amount of which shall be determined based upon the conversion rights of the Series A Preferred. The beneficial interests in the Trust to be issued to SCO's equity holders shall represent a *pro rata* interest in the outstanding New Common Stock held by the Trust, which will correspond to the percentage interests of SCO's equity holders (and common stock equivalent holders) at the time of the organization of the Trust. The Trust will receive \$2 million on the Effective Date of the Plan (from the \$5 million proceeds of the Series A Preferred), which will be distributed to Trust beneficiaries (in respect of holdings of common stock and excluding holders of common stock equivalents) after reserving for reasonable Trust expenses. Within one year after the pending litigation claims in the Novell/IBM Litigation are finally resolved (by final order, not subject to further appeal, or settlement), reorganized SCO will make a final payment to redeem all New Common Stock held by the Trust in an amount equal to the sum of (a) a percentage of any net recovery reorganized SCO realizes from the final resolution of the Novell/IBM litigation (net of any recovery on or settlement of counterclaims and cross claims against SCO, and net of all taxes, and legal and other professional fees and expenses incurred by SCO in connection therewith), such percentage to vary between 15% and 49% depending on the conversion percentage of the Series A Preferred, and (b) the product obtained by multiplying (i) SCO's earnings (excluding any earnings arising from a Novell/IBM litigation recovery) before interest, taxes, depreciation and amortization (over the four full fiscal quarters immediately preceding the resolution of the Novell/IBM litigation), by (ii) the product of four times the percentage (between 15% and 49%) determined under (a), above; and
- (h) Interests in the Trust shall not be transferrable, and the reorganized SCO will no longer be a public company and shall not be subject to the reporting requirements of the Securities Exchange Act of 1934, as amended.

7. A primary purpose and intended results of the Plan, and the financing commitments provided under the MOU, is to encourage and promote an early and favorable resolution of the Novell/IBM Litigation. Notwithstanding the August 2007 interim ruling by the Utah District Court in the Novell Litigation, SCO believes it has an excellent chance to prevail in the Novell/IBM Litigation, including potential for an award of substantial damages in its favor should SCO prevail. The financing commitments provided under the MOU increase SCO's ability to succeed in the Novell/IBM Litigation from a practical perspective, and therefore SNCP has required the inclusion of the Plan Sponsor Protections (as defined below) in the MOU.

8. SNCP requires the following in the MOU (the "Plan Sponsor Protections"): (a) the right to participate directly in any settlement discussions relating to the Novell/IBM Litigation, and (b) the right to share equally with SCO in any net proceeds of a favorable resolution of the Novell/IBM Litigation prior to the Effective Date of the Plan (whether structured as a settlement, a purchase of SCO, or an exclusive licensing arrangement) as an administrative expense. The MOU provides that SNCP has no obligation to proceed with its financing commitments or the Plan unless the Court approves the Plan Sponsor Protections.

9. The Debtors concede that the Plan Sponsor Protections seek extraordinary relief from the Court. The Debtors' support for that relief, and the benefits that the SNCP financing commitments and the Plan offer this estate, are at least as extraordinary. SCO's litigation position in the Novell/IBM Litigation will benefit immediately and substantially by SNCP's \$100 million financing commitments.

10. The Debtors' creditors will benefit from SNCP's financing under the Plan as they will be paid in full, with interest, on the earlier of the Effective Date of the Plan or the date their claims are allowed.

11. The benefits of the Plan and financing to SCO's equity interest holders are extraordinary. The Plan allows SCO's equity holders to receive not only payment in full of the present value of their common stock, on or about the Effective Date of the Plan, but also preserves for equity holders the benefit of a potential subsequent distribution to retire their interests in SCO, in cash equal to up to almost half of: (i) the net proceeds from the resolution of the Novell/IBM Litigation, *plus* (ii) 4 times SCO's 12-month trailing EBITDA value.

12. The Plan Sponsor Protections grant SNCP an extraordinary share in the potential Novell/IBM Litigation net settlement proceeds generated before the Effective Date of the Plan because of: (a) the possibility that the SNCP financing commitments and Plan could be the cause creating Novell/IBM Litigation net settlement proceeds, in substantial amounts, before the Effective Date of the Plan, (b) the entire certainty that if there are no Novell/IBM Litigation net settlement proceeds generated before the Effective Date of the Plan, the Plan Sponsor Protections are, and were always, entirely moot, and never cost the Debtors a penny, and (c) the extraordinary benefits the Plan offers all parties in interest in these cases.

13. The Plan Sponsor Protections first focus on allowing SNCP to participate in negotiations to resolve the Novell/IBM Litigation. Pursuant to the MOU, if SCO receives either: (a) a written or oral offer or counteroffer to settle the Novell/IBM Litigation, Autozone Litigation or any other pending litigation (collectively, the "Pending Litigation") prior to the Effective Date of the Plan; or (b) a written or oral offer or counteroffer to acquire the Debtors by,

or for the account of, a defendant in the Pending Litigation, the Debtors shall promptly notify SNCP of the offer and all material terms thereof. Similarly, the Debtors shall promptly advise SNCP of all offers (including counteroffers) it makes to settle or resolve the Pending Litigation. At its option, one or more representatives of SNCP may attend settlement conferences or conference calls between the parties to the Pending Litigation, whether the same are directed at settling the Pending Litigation or acquiring the Debtors. At the request of the Debtors, each representative of the SNCP who shall attend settlement conferences or conference calls between the parties to the Pending Litigation shall execute a confidentiality agreement reasonably acceptable to the Debtors and SNCP.

14. The Plan Sponsor Protections also implement the intent of the MOU for the Debtors and SNCP to share equally the Novell/IBM Litigation net settlement proceeds that may be realized before the Effective Date of the Plan, despite the form that resolution the pending litigation may take, including a sale or exclusive licensing arrangement. If the Novell/IBM Litigation is not resolved before the Effective Date, these Plan Sponsor Protections cost the Debtors' estates nothing.

15. The Debtors believe that absent the SNCP financing commitments provided for under the Plan, the Debtors' chances to reach a favorable resolution of the Novell/IBM Litigation by the proposed Effective Date of the Plan (i.e., not later than August 15, 2008) would be more difficult. In all events, it is certain that SNCP's \$100 million financing commitment to support the Novell/IBM Litigation will immediately and substantially enhance SCO's litigation position.

16. If the Novell/IBM Litigation is resolved in reorganized SCO's favor after the Effective Date of the Plan, the MOU gives the equity security holders of SCO essentially as much as SNCP requests in the Plan Sponsor Protections. Specifically, under the MOU and Plan, within one year after the Novell/IBM Litigation resolves, reorganized SCO will redeem the Trust's common stock interests for up to 49% of the net settlement proceeds (vs. 50% required by the Plan Sponsor Protections) plus an equal share of SCO's value at 4 times EBITDA.

17. In the extraordinary event that the Novell/IBM Litigation is resolved in SCO's favor before the Effective Date of the Plan, and the Court nonetheless does not confirm the Plan, the Plan Sponsor Protections grant SNCP an equal share of such net proceeds as an administrative expense, payable promptly after the Debtors' receipt of such net settlement (or sales proceeds) and subsequent Bankruptcy Court order refusing to permit confirmation or consummation of the Plan.

18. In addition to the Settlement Compensation, SNCP shall be entitled in the circumstances in which the Settlement Compensation becomes payable, to complete its acquisition of the Series A Preferred upon payment of the \$5 million purchase price therefor, before, at the time of, or immediately after the Reorganized Debtor emerges from bankruptcy. In connection with the payment of the Settlement Compensation or the Sale Compensation or if the MOU is terminated by SNCP for any of the reasons set forth under the "Termination of the Transaction" section of the MOU that are not directly attributable to the act or omission of the SNCP, then SNCP shall also be entitled to an administrative claim for reimbursement from the Debtors of its out of pocket fees, costs and expenses (up to \$500,000) incurred in connection therewith (the "Expense Reimbursement"). Significantly, SNCP shall not be entitled to any



Expense Reimbursement if it terminates the Plan as a result of its due diligence investigations regarding the Debtor, and SNCP's rights to so terminate the Plan expire at the hearing on approval of the Disclosure Statement.

**Relief Requested**

19. By this Motion, the Debtors request entry of an order, in the form attached hereto approving the Plan Sponsor Protections, including the payment of Settlement Compensation or Sale Compensation, as defined and provided for in the MOU, as and if applicable, as well as the Expense Reimbursement. The MOU requires that the Plan Sponsor Protections be allowed as an administrative expense, payable promptly after the Debtors' receipt of net settlement or sale proceeds and after the Court enters an order denying confirmation of the Plan.

20. The MOU provides that SNCP may terminate its financing and other commitments to SCO unless the Court approves the Plan Sponsor Protections. The Court should approve the Plan Sponsor Protections because the Plan it sponsors provides for full payment of all claims and interests on the Effective Date (or the date the claim or interest becomes allowed), and essentially up to an almost equal sharing of Novell/IBM Litigation net proceeds plus SCO's equity value, payable to holders of equity interests by a distribution after the Effective Date. The Plan proposes to pay all creditors in full plus interest, gives holders of common stock an immediate distribution about equal to their present market value, and substantial additional potential upside in a distribution after the Effective Date.

21. The Debtors acknowledge the lack of precedent for the Settlement Compensation and Sale Compensation components of the Plan Sponsor Protections. However,

the Debtors believe that the Plan Sponsor Protections are necessary and will benefit the Debtors' estates, their creditors and equity security holders because: (i) approval of the Plan Sponsor Protections by the Court is a condition to the effectiveness of the MOU; (ii) the MOU provides the funding and financing necessary for the Plan; (iii) any scenario under which the Debtors would settle the Pending Litigation or sell substantially all of their assets would be premised upon: (a) creditors of the estates being treated as they would under the Plan, and (b) holders of equity interests getting greater value than proposed under the Plan even after the payment of the Plan Sponsor Protections.

22. The Bankruptcy Code authorizes the Court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105. One purpose of the Bankruptcy Code, and chapter 11 in particular, is to allow the reorganization of a company. Here, the Plan Sponsor Protections are part and parcel of the Debtors' Plan and will allow the Debtors to reorganize and emerge successfully from their chapter 11 cases. The Third Circuit has interpreted section 105 on numerous occasions:

In *In re Continental Airlines*, 203 F.3d 203 (3d Cir.2000), we observed that § 105(a) "supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code." *Id.* at 211. We cautioned that § 105(a) "has a limited scope. It does not 'create substantive rights that would otherwise be unavailable under the Bankruptcy Code.'" *Id.* (quoting *United States v. Pepperman*, 976 F.2d 123, 131 (3d Cir.1992)). This instruction was consistent with our earlier observation in *In re Morristown & Erie Railroad Co.*, 885 F.2d 98 (3d Cir.1990), that § 105(a) authorize[s] the bankruptcy court, or the district court sitting in bankruptcy, to fashion such orders as are required to further the substantive provisions of the Code. Section 105(a) gives the court general equitable powers, but only insofar as those powers are applied in a manner consistent with the Code. Nor does section 105(a) give the court the power to create substantive rights that

would otherwise be unavailable under the Code. *Id.* at 100 (citations omitted).

*Morristown* reveals this Court's considered view that § 105(a) is a powerful, versatile tool, but that it operates only within the context of bankruptcy proceedings. Section 105(a) empowers bankruptcy courts and district courts sitting in bankruptcy to fashion orders in furtherance of Bankruptcy Code provisions.

*In re Joubert*, 411 F.3d 452, 455 (3d Cir. 2005).

23. In *U.S. v. Energy Resources Co., Inc.*, the bankruptcy court confirmed a plan of reorganization that designated tax payments as trust funds. The Supreme Court held that:

The Bankruptcy Code does not explicitly authorize the bankruptcy courts to approve reorganization plans designating tax payments as either trust fund or nontrust fund. The Code, however, grants the bankruptcy courts residual authority to approve reorganization plans including "any ... appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C. § 1123(b)(5); see also § 1129. The Code also states that bankruptcy courts may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. § 105(a). These statutory directives are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships. *See Pepper v. Litton*, 308 U.S. 295, 303-304, 60 S.Ct. 238, 243-244, 84 L.Ed. 281 (1939); *United States National Bank v. Chase National Bank*, 331 U.S. 28, 36, 67 S.Ct. 1041, 1045, 91 L.Ed. 1320 (1947); *Katchen v. Landy*, 382 U.S. 323, 327, 86 S.Ct. 467, 471, 15 L.Ed.2d 391 (1966).

495 U.S. 545, 549 (1990). Here, the Debtors are asking the Court to supplement rights for purposes that exist under the Bankruptcy Code. The Debtors are seeking approval of a transaction that will enable them to reorganize and emerge from these cases pursuant to terms that would be enforceable under state contract law. The Debtors submit that there will not be any modification of the creditor-debtor relationship and holders of equity interests of SCO will not be in any worse position as a result of the requested relief.

24. The Debtors further submit that the Plan Sponsor Protections should be allowed as an administrative expense because, as discussed hereinabove, the Debtors believe that if the Novell/IBM Litigation is resolved favorably or if a third party makes an offer to purchase substantially all of the Debtors' assets, the cause for such settlement or sale will have been the fact that SNCP committed to provide the financing necessary for the Debtors to emerge from bankruptcy, continue the research, development and growth of their businesses and continue the Novell/IBM Litigation and other pending litigation. The Debtors submit that the Plan Sponsor Protections can be analogized to the allowance of an administrative expense to a creditor that provided a "substantial contribution." Substantial contribution has been interpreted as a contribution that "foster[s] and enhance[s], rather than retard[s] or interrupt[s] the progress of reorganization." *Speights & Runyan v. Celotex Corp., (In re Celotex Corp.)*, 227 F.3d 1336, 1338 (11<sup>th</sup> Cir. 2000) (quoting *In re Consolidated Bancshares, Inc.*, 785 F.2d 1248, 1253 (5<sup>th</sup> Cir. 1986) (quoting *In re Richton Int'l Corp.*, 15 B.R. 854, 856 (Bankr. S.D.N.Y. 1981)). A creditor can be reimbursed for providing a substantial contribution where it "directly and materially" contributes to a reorganization. *Id.* (citing *In re Lebron*, 27 F.3d 937, 943 (3<sup>rd</sup> Cir. 1994)). *See also In re Best Products Co., Inc.*, 173 B.R. 862, 865 (Bankr. S.D.N.Y. 1994) (substantial contribution require applicants to prove that they provided "**actual and demonstrable benefit** to the debtor's estate, its creditors and to the extent relevant, the debtor's shareholders") (emphasis added) (citations omitted)); *In re Big Rivers Elec. Corp.*, 233 B.R. 739, 746 (W.D. Kentucky 1998) ("the court must determine whether the party's action conferred a direct, substantial, or meaningful benefit to the bankruptcy estate"). Such involvement "takes the form of constructive contributions in key reorganizational aspects, when **but for** the role of the creditor, the movement

towards final reorganization would have been substantially diminished.” *In re 9085 E. Mineral Office Bldg., Ltd.*, 119 B.R. 246, 250 (Bankr. D. Colo. 1990) (emphasis added).

25. While the Debtors admit that SNCP is not a creditor, the Debtors believe that “but for” SNCP’s commitments under the MOU, the Debtors’ chances for achieving a favorable settlement of the Novell/IBM Litigation or sale of substantially all of their assets would be more difficult.

26. Further, the Debtors believe that the Plan Sponsor Protections encourage a potential plan sponsor who invests time, money and effort to negotiate with a debtor to take the risks and uncertainties that come with the Chapter 11 bankruptcy process.

27. In consideration of the benefits of the Plan Sponsor Protections, and the value of the Debtors as a going concern, the Debtors submit that the Plan Sponsor Protections are reasonable and appropriate and will serve to maximize the value that the Debtors’ creditors and equity holders will recover under the Plan.

### **Notice**

28. Notice of this Motion has been or will be given to the following parties or, in lieu thereof, to their counsel, if known: (i) the Office of the United States Trustee; (ii) all creditors; (iii) all holders of equity interests in SCO; and (iv) any party which has filed a request for notices with this Court prior to the date of this Motion. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

WHEREFORE, the Debtors respectfully request entry of an order in the form attached granting the relief requested herein, as well as granting any other and further relief the Court deems just and proper.

Dated: February 14, 2008

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