

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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

MOTION OF DEBTORS FOR AN ORDER (I) AUTHORIZING THE DEBTORS TO PAY PREPETITION SALES AND USE, FRANCHISE AND SIMILAR TAXES AND REGULATORY FEES IN THE ORDINARY COURSE OF BUSINESS AND (II) AUTHORIZING BANKS AND FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED THERETO

The SCO Group, Inc. and SCO Operations, Inc. (collectively, “SCO” or the “Debtors”) move for entry of an order authorizing the Debtors to pay prepetition sales and use, business and occupation, franchise, gross receipts and similar taxes and regulatory fees in the ordinary course of business and authorizing banks and financial institutions to honor and process checks and transfers related to such payments. In support of this motion (the “Motion”), the Debtors respectfully state as follows:

Jurisdiction

1. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding. 28 U.S.C. § 157(b)(2)(A) and (M).

¹ 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. The address for both Debtors is 355 South 520 West, Lindon, UT 84042.

2. The statutory bases for the relief requested herein are sections 105(a), 345(b), 363, 364(b)(1), 1107 and 1108 of title 11 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”).

Background

3. On the date hereof (the “Petition Date”), the Debtors commenced these cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code.

4. The Debtors are in possession of their property and continue to operate and manage their business as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

5. The Debtors are a leading provider of software technology for distributed, embedded, network-based, and mobile systems, offering SCO OpenServer for small to medium business, UnixWare, and SCO Mobile Server for enterprise applications and digital network services.

6. The SCO Group, Inc. (“SCO”) is a Delaware corporation traded on the NASDAQ stock exchange under the ticker symbol “SCOX.”

7. SCO Operations, Inc. is a Delaware corporation that is wholly owned by SCO and operates the research, development, sales and implementation of technology owned by SCO.

8. For a detailed description of the Debtors and their operations, the Debtors respectfully refer the Court and parties in interest to the *Declaration of Darl C. McBride, Chief Financial Officer, in Support of First Day Pleadings* filed contemporaneously herewith and incorporated herein by reference.

**The Debtors' Sales and Use, Franchise
and Similar Taxes and Regulatory Fees**

9. In connection with the normal operation of their business, the Debtors pay an assortment of sales and use, business and occupations, gross receipts, business privilege and similar taxes (the "Taxes") to various federal, state, and local taxing authorities (collectively, the "Taxing Authorities") and pay various regulatory fees ("Regulatory Fees") to federal, state, and local regulatory authorities (collectively, the "Regulatory Authorities," and together with the Taxing Authorities, the "Taxing and Regulatory Authorities"), including, but not limited to, those Taxing and Regulatory Authorities for the States listed on Exhibit A annexed hereto. These taxes and fees include, without limitation, the following:

10. Sales Taxes: In connection with the provision of software technology to customers, the Debtors collect and remit or otherwise pay an assortment of sales and use, business and occupation taxes (collectively, the "Sales Taxes") to the Taxing Authorities. Sales Taxes are paid in the ordinary course of the Debtors' business, and are calculated based upon statutorily mandated percentages. The Debtors remit the Sales Taxes annually, semi-annually, quarterly or monthly, depending on the particular Taxing Authority. Such Sales Taxes could include both amounts not yet due and amounts paid by checks sent prior to the Petition Date that have not cleared the Debtors' bank accounts on the Petition Date, although the Debtors are not aware of any such checks that have not cleared. The Debtors estimate that the aggregate prepetition Sales Taxes unpaid as of the Petition Date is no more than approximately \$54,000.

11. Franchise Taxes: The Debtors also pay in the ordinary course of their business franchise excise and similar taxes required to maintain their existence or continue to do

business in various jurisdictions (the “Franchise Taxes”). Such Franchise Taxes could include both amounts not yet due and amounts paid by checks sent prior to the Petition Date that have not cleared the Debtors’ bank accounts on the Petition Date, although the Debtors are not aware of any such checks that have not cleared. The Debtors estimate that on the Petition Date they owe no more than approximately \$9,300 in Franchise Taxes. In addition, amounts may become due and payable after the Debtors’ fiscal year, October 31, 2007. These amounts, not yet due and payable, arguably are not prepetition obligations, and this Motion is filed with respect to these amounts in an abundance of caution. Other franchise taxes may become payable with respect to fiscal years that have not ended, and the Debtors assert that payment of these amounts can be made postpetition in the ordinary course of business.

12. Regulatory Fees: Many municipal and county governments require the Debtors to obtain a business license and to pay corresponding business license fees and business operating taxes (the “Regulatory Fees”). The requirements for a company to obtain a business license and the manner that the Regulatory Fees are computed vary greatly according to the local tax laws. The Debtors estimate that they do not owe any Regulatory Fees as of the Petition Date. The Debtors nonetheless seek authority to pay any such unpaid Regulatory Fees, provided that any such payment falls within any aggregate cap contained in the order entered by this Court.

Relief Requested

13. By this Motion, pursuant to sections 105(a), 363 and 507(a) of the Bankruptcy Code, the Debtors seek authority to pay, in the Debtors’ sole discretion, prepetition Taxes and Regulatory Fees owed to the Taxing and Regulatory Authorities, including, without limitation, Taxes and Regulatory Fees subsequently determined upon audit to be owed for

periods prior to the Petition Date, in an aggregate amount (excluding amounts paid prepetition by checks that have not yet cleared on the Petition Date) not to exceed \$63,300, which is the aggregate maximum sum that the Debtors currently believe will be due on account of prepetition Taxes and Regulatory Fees.

14. To the extent any check issued or electronic transfer initiated prior to the Petition Date to satisfy any prepetition obligation on account of Taxes or Regulatory Fees has not cleared the Banks as of the Petition Date, the Debtors request the Court to authorize the Banks, when requested by the Debtors in their sole discretion, to receive, process, honor, and pay such checks or electronic transfers, provided that there are sufficient funds available in the applicable accounts to make such payments. The Debtors also seek authorization to issue replacement checks, or to provide for other means of payment to the Taxing and Regulatory Authorities, to the extent necessary to pay such outstanding Taxes and Regulatory Fees owing for periods prior to the Petition Date.²

15. For the reasons described below, the payment of prepetition Taxes and Regulatory Fees will help the Debtors avoid serious disruption to its operations and reorganization efforts that would result from the nonpayment of such taxes and fees, including the distraction and adverse affect on morale that could result from liability for nonpayment imposed upon the Debtors' directors and officers.

Basis For Relief

² Because each of the checks or electronic transfers is readily identified as relating directly to an authorized payment of prepetition Sales Taxes and Regulatory Fees, the Debtors believe that checks and electronic transfers for payments that are not authorized will not be honored inadvertently.

16. Section 541(d) of the Bankruptcy Code provides, in relevant part, that “[p]roperty in which the debtor holds, as of the commencement of the commencement of the case, only legal title and not an equitable interest ... becomes property of the estate under subsection (a)(1) or (a)(2) of this section only to the extent of the debtor’s legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.” *See* 11 U.S.C. § 541(d).

17. Certain of the Taxes and Regulatory Fees may constitute so-called “trust fund” taxes to be collected from third parties and held in trust for payment to the Taxing and Regulatory Authorities. *See, e.g., In re Edison Bros., Inc.*, 243 B.R. 231, 235 (Bankr. D. Del. 2000) (noting that property held in trust, whether constructively or expressly, does not become part of the estate when the debtor files its bankruptcy petition), *reconsideration denied*, 2001 Bankr. LEXIS 1333 (Bankr. D. Del. 2001). *See also In re Shank*, 792 F.2d 829, 830 (9th Cir. 1986) (sales tax required by state law to be collected by sellers for their customers is a trust fund tax); *DeChiaro v. New York State Tax Comm’n*, 760 F.2d 432, 433-34 (2d Cir. 1985) (sales taxes are trust fund taxes); *Rosenow v. Illinois*, 715 F.2d 277, 282 (7th Cir. 1983) (use tax is a trust fund tax); *In re Hilaire*, 135 B.R. 186, 191-92 (D. Mass. 1991) (sales tax is a trust fund tax). To the extent these “trust fund” taxes are collected, they are not property of the Debtors’ estates under section 541(d) of the Bankruptcy Code.³ *See Begier v. IRS*, 496 U.S. 53, 59 (1990). *See*

³ 11 U.S.C. § 541(d) provides:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor’s legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

also *In re American Int'l Airways, Inc.*, 70 B.R. 102, 103 (Bankr. E.D. Pa. 1987) (excise and withholding taxes), *aff'd*, *In re American Int'l Airways, Inc.*, 1987 U.S. Dist. LEXIS 16856 (E.D. Pa. 1987); *In re Tap, Inc.*, 52 B.R. 271, 278 (Bankr. D. Mass. 1985) (withholding taxes); 5 COLLIER ON BANKRUPTCY, ¶541.11[4], at 541-67 to 541-68 (15th ed. rev. 2001). The Debtors, therefore, do not have any equitable interest in these Taxes and Regulatory Fees.

18. Further, in states that have enacted laws providing that certain of the Taxes and/or Regulatory Fees constitute trust fund taxes, officers and directors of the collecting debtor entity may be held personally liable for nonpayment of such Taxes and/or Regulatory Fees. *See, e.g.*, John F. Olson, *et al.*, DIRECTOR & OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE § 3.04, at 3-20.27 (rel.10-1999) (“some states hold corporate officers personally liable for any sales tax and penalty owed and not paid by the corporation, regardless of cause”). *See e.g.*, OHIO REV. CODE ANN. § 5739.33 (2005); FLA. STAT. § 213.29 (2005). To the extent any accrued Taxes and Regulatory Fees of the Debtors were unpaid as of the Petition Date, the Debtors’ officers and directors may be subject to lawsuits in such jurisdictions during these Chapter 11 cases. Such potential lawsuits would prove extremely distracting for: (a) the Debtors; (b) the named officers and directors whose attention to the Debtors’ reorganization process is required; and (c) this Court, which might be asked to entertain various motions seeking injunctions with respect to the potential state court actions. It is in the best interests of the Debtors’ estates to eliminate the possibility of the foregoing distraction.

19. In addition, it is likely that some, if not all, of the Taxes and Regulatory Fees are entitled to priority status pursuant to 11 U.S.C. § 507(a)(8). *See* 11 U.S.C. § 507(a)(8)(A) (taxes measured on gross income); 11 U.S.C. § 507(a)(8)(C) (“trust fund” taxes);

11 U.S.C. § 507(a)(8)(E) (excise taxes).⁴ Under any plan of reorganization, these priority Taxes and Regulatory Fees must be paid in full and in regular cash installments over a five-year period from the date of the order for relief. *See* 11 U.S.C. § 1129(a)(9)(C)(i)-(ii). Additionally, such Taxes and Regulatory Fees must be paid in the order of priority no less favorable than the treatment given to the most favored general unsecured claims. *See* 11 U.S.C. § 1129(a)(9)(C)(iii). Finally, any plan of reorganization must provide the same treatment of those Taxes and Regulatory Fees that constituted secured claims that, were they unsecured, would have been priority tax claims under 11 U.S.C. § 507(a)(8). *See* 11 U.S.C. § 1129(a)(9)(D). Thus, in most cases, the payment of the Taxes and Regulatory Fees that are entitled to such priority in the ordinary course of the Debtors' business only affects the timing of the payment and does not prejudice the rights of other creditors of the Debtors.

20. Courts have also authorized debtors to pay the Taxes and Regulatory Fees under section 363(b)(1) of the Bankruptcy Code, which provides that "the trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." Under such section, a court may authorize a debtor to pay certain prepetition claims. *See In re FV Steel & Wire Co.*, Case No. 04-22421 (Bankr. E.D. Wis. Feb. 26, 2004) (authorizing the continuation of customer programs and the payment of prepetition claims under section 363 of the Bankruptcy Code); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (affirming lower court order authorizing payment of prepetition wages pursuant

⁴ For bankruptcy purposes, a tax is characterized as (1) an involuntary pecuniary burden, regardless of name, laid upon the individual or property; (2) imposed by, or under authority of the legislature; (3) for the public purposes, including the purposes of defraying expenses of government or undertakings authorized by it; and (4) under the police or taxing power of the state. *In re Chateaugay Corp.*, 53 F.3d 478, 498 (2d Cir. 1995) (citation omitted).

to section 363(b) of the Bankruptcy Code); *In re UAL Corp.*, Case No. 02-48191 (Bankr. N.D. Ill. Dec. 9, 2002) (authorizing payment of prepetition claims under section 363 of the Bankruptcy Code as an out-of-the-ordinary-course transaction). To do so, “the debtor must articulate some business justification, other than the mere appeasement of major creditors.” *Ionosphere Clubs*, 98 B.R. at 175. As discussed herein, the Debtors’ failure to pay the Taxes and Regulatory Fees could have a material adverse impact on their ability to operate in the ordinary course of business.

21. Finally, section 105(a) of the Bankruptcy Code provides that “(t)he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” *See* 11 U.S.C. § 105(a). The purpose of section 105(a) is “to assure the bankruptcy courts [sic] power to take whatever action is appropriate or necessary in aid of the exercise of their jurisdiction.” *See* 2 COLLIER ON BANKRUPTCY, ¶105.01, at 105-5 to 105-6 (15th ed. rev. 2001). Thus section 105 essentially codifies the bankruptcy court’s inherent equitable powers. *See Management Tech. Corp. v. Pardo*, 56 B.R. 337, 339 (Bankr. D. N.J. 1985) (noting that the court’s equitable power is derived from section 105).

22. Numerous courts have used section 105 equitable powers under the “necessity of payment doctrine” to authorize payment of a debtor’s prepetition obligations where, as here, such payment is necessary to effectuate the “paramount purpose” of a chapter 11 reorganization, which is to prevent the debtor from going into liquidation and preserve the debtor’s potential for rehabilitation. *See In re Lehigh & New England Rv. Co.*, 657 F.2d 570, 581 (3d Cir. 1981); *In re Ionosphere Clubs, Inc.*, 98 B.R. at 176-77 (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)). This doctrine, first articulated by the United State Supreme

Court in *Miltenberger v. Logansport, C. & S.W.R. Co.*, 106 U.S. 286, 311-312 (1882), recognizes the existence of judicial power to authorize a debtor in a reorganization case to pay prepetition claims where such payment is essential to the continued operation of the debtor.

23. Moreover, under section 105(a) of the Bankruptcy Code, courts, including numerous courts in this District, have authorized debtors in possession to pay a variety of prepetition claims of creditors, including claims similar to the Taxes and Regulatory Fees herein. *See, e.g., In re Mortgage Lenders Network, USA, Inc.*, Case No. 07-10146 (Bank. D. Del. February 5, 2007); *In re Radnor Holdings Corporation, et al.*, Case No. 06-10894 (PJW) (Bank. D. Del. August 23, 2006); *In re Werner Holdings Co. (DE), Inc., et al.*, Case No. 06-10578 (KJC) (Bank. D. Del. June 13, 2006); *In re Global Home Products, et al.*, Case No. 06-10340 (KG) (Bankr. D. Del. April 11, 2006); *In re J.L. French Automotive Castings, et al.*, Case No. 06-10119 (MFW) (Bankr. D. Del. February 14, 2006); The Debtors submit that the present circumstances warrant similar relief in these Chapter 11 cases.

24. Nothing in this Motion should be construed as impairing the Debtors' right to contest the amount or priority of any Taxes and Regulatory Fees that may be owed to any Taxing Authority or Regulatory Authority, and the Debtors expressly reserve all of their rights with respect thereto.

Notice

25. Notice of this Motion has been given to the Office of the U.S. Trustee, 844 King Street, Suite 2207, Lockbox 35, Wilmington, DE 19801; and (iii) the 20 largest unsecured creditors of the Debtors. As the Motion is seeking "first day" relief, within two business days of the hearing on the Motion, the Debtors will serve copies of the Motion and any order entered

respecting the Motion as required by Del. Bankr. LR 9013-2(d). 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 that this Court enter an order, substantially in the form attached hereto, granting the relief requested herein and such other or further relief as this Court deems appropriate.

Dated: September 14, 2007

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