IN THE UNITED STATES DISTRICT COURT

DISTRICT OF UTAH

CENTRAL DIVISION

THE SCO GROUP,)

Plaintiff,)

vs.) CASE NO. 2:03-CV-294DAK

INTERNATIONAL BUSINESS)

MACHINES CORPORATION,)

Defendant.)

_____)

BEFORE THE HONORABLE DALE A. KIMBALL

March 5, 2007

Motion Hearing

SEALED PORTION, PAGES 25-45, OMITTED

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March 5, 2007 2:30 p.m.

P R O C E E D I N G S

THE COURT: We're here this afternoon in the matter of The SCO Group versus IBM, 2:03-CV-294.

This afternoon we'll hear two motions. First, IBM's motion for summary judgment on SCO's unfair competition claim, and then IBM's motion for summary judgment on SCO's interference claims. The first motion is the sixth cause of action, and the seventh, eight and ninth with respect to the second motion.

30 minutes a side on each motion, correct?

MR. MARRIOTT: Yes.

THE COURT: Who is going to argue, Mr. Marriott?

MR. MARRIOTT: I am, Your Honor.

THE COURT: We'll start with your summary judgment motion on the sixth cause of action.

Go ahead.

MR. NORMAND: Your Honor, as an initial matter, if I could, we have been in touch with counsel for IBM on the issue of confidentiality of the documents that are going to be an issue in argument, documents to be cited to in our argument and even displayed on the boards, and it is my understanding that IBM has continued to assert the confidentiality of those documents. If that is true, Your

Honor may want to consider whether the courtroom should be vacated for purposes of the argument, at least our portion of the argument.

MR. MARRIOTT: Your Honor, I am not sure specifically what documents Mr. Normand is referring to. If there are documents that have been designated as confidential under the terms of the protective order, they shouldn't be disclosed. Mr. Normand, I would think in his argument, is simply pointing them out to the Court without the need to close the courtroom, but if he feels the need to disclose the content of the documents in open court, I would think that you would have to clear the courtroom to preserve the confidentiality of whatever it is that he intends to show.

MR. NORMAND: My understanding, Your Honor, was that it would not be inappropriate to show the documents in court to merely the attorneys who are here. That is the point I'm making.

THE COURT: Well, you want to show documents that have been marked confidential?

MR. NORMAND: I do. I want to display them on the boards, and I want to walk the Court through them.

THE COURT: Do you remember you only have 30 minutes?

MR. NORMAND: I understand that, Your Honor.

THE COURT: Then the court will have to be cleared except for the lawyers when you do that. That basically would be your whole argument, I assume.

MR. NORMAND: Hopefully that won't take 30 minutes, Your Honor.

THE COURT: No. But, I mean, administratively it is somewhat awkward to break up your argument and clear the courtroom for part of it and not the rest of it.

Right?

MR. NORMAND: The reason I'm raising the issue now, Your Honor, is I'm asking whether it makes sense to clear the courtroom now for purposes of this argument for both sides. The boards will be up during the entirety of my argument.

THE COURT: But not his?

MR. NORMAND: No, sir.

If Your Honor is comfortable with us vacating the courtroom when Mr. Marriott is finished his opening remarks, that is fine with me.

THE COURT: Yes. If he is not going to show any confidential documents, it does not have to be cleared until the documents come up. Apparently it is in your argument.

MR. NORMAND: Correct.

THE COURT: Go ahead, Mr. Marriott.

MR. MARRIOTT: Thank you, Your Honor.

As usual we have a book, if I may approach?

THE COURT: Sure.

MR. MARRIOTT: SCO's unfair competition claim appears at paragraphs 181 through 188 of its second amended complaint. At the bottom, Judge, that claim is about the supposed improper taking by IBM of source code that it obtained during the so-called Project Monterey, and used in its AIX for Power operating system.

With Your Honor's permission --

THE COURT: Monterey was between IBM and Santa Cruz, correct?

MR. MARRIOTT: That is correct.

With Your Honor's permission, what I would like to do is explain why it is, first, that SCO's claims depend fundamentally on the idea that IBM improperly took code from Monterey and put it into its AIX for Power project, and then why those allegations lack merit.

THE COURT: Excuse me. I forget to note appearances because Mr. Normand got me thinking about these confidential documents. I didn't mention who was here, did I?

Mr. Brent Hatch for plaintiff. Mr. Ted Normand, Mr. Stuart Singer, Mr. Mark James. For defendants Mr. David Marriott, Ms. Amy Sorenson, Mr. Michael Burke and Mr. Todd Shaughnessy and Mr. Greg Lembrich.

Pardon me, Mr. Marriott.

MR. MARRIOTT: Not a problem.

With Your Honor's permission, what I would like to do is --

THE COURT: Don't ever ask me anything until I do all that preliminary stuff.

MR. NORMAND: Sorry, Your Honor.

MR. MARRIOTT: What I would like to do is explain why SCO's unfair competition claim depends, Your Honor, fundamentally on IBM taking code from Project Monterey and putting it into its AIX operating system. And then offer the Court five independent reasons why SCO's claim for unfair competition as to that conduct fails, Your Honor, to survive our motion for summary judgment.

If I could have Your Honor please turn to tab one of the book, the allegedly improper conduct at issue on this motion is set out in paragraph 184 of SCO's complaint. What IBM is alleged to have done, Your Honor, is the following: Misappropriated the source code, breached the contract, violated confidentiality provisions running to the benefit of the plaintiff, and inducing and encouraging ours to violate confidentiality provisions, contributing protected code to Linux, using deceptive means and practices and other unlawful competition.

If Your Honor will look at tab two of the book,

you will see, I think, that all of this alleged misconduct effectively, again, amounts to an allegation that IBM improperly took code from Project Monterey and put it into its AIX for Power operating system. Let's take a look at each of those.

Your Honor, as to B, C and E, the allegation is in effect that IBM breached the contract. We have separately moved for summary judgment with respect to IBM's -- with respect to SCO's claims that IBM breached its contractual obligations. Just as we believe those claims fail, we believe any attempt to incorporate those allegations here fail. As I'll come back to, Your Honor, a breach of contract is not under the controlling law in any case unfair competition.

Item D, Your Honor, is pled as a piece of SCO's tortious interference claim. The allegation is that IBM induced and encouraged others to breach confidentiality agreements. SCO has, I submit, effectively abandoned that. There is not a shred of evidence that supports that contention. In any event, tortious interference is not unfair competition.

Item A, Your Honor, represents the crux of what this claim is about. Again, supposedly taking code from Monterey and putting it into IBM's AIX for Power operating system in violation of SCO's rights. Items F and G broadly

allege misconduct, deceptive means and practices and other unlawful and unfair competition. At the end of the day the only thing that is identified by SCO in its opposition papers as representing the supposed misconduct, is IBM allegedly failing to disclose that it was going to support Linux and move away from project Monterey, IBM supposedly stringing along the project, the Monterey project in an effort to put out a sham PRPQ, a sham release of this product to get a license.

At the bottom, Judge, those allegations are either contract based, because they allege a failure of the implied covenant of good faith and fair dealing in the Monterey agreement, or they are merely predicates to SCO's claim that IBM has no license to include code from Monterey in its AIX for Power product.

With that introduction, let me come to the five separate reasons why SCO's claim fails. And I should note, Your Honor, here at the outset, that if the allegation sounds familiar that IBM improperly took code from Monterey and put in it its AIX for Power product, it is because SCO endeavored to include in this case that exact allegation and that exact conduct by way of its proposed third amended complaint, which the Court said they could not properly bring because it was not timely brought.

So the independent reasons why summary judgment

should be entered in favor of IBM, Your Honor, are, one, SCO can't adduce evidence sufficient to make out a claim for unfair competition; two, the claim is preempted by federal copyright law; three, the claim is untimely, and under the joint development agreement and the limitations provision --

THE COURT: With respect to three, they are going to tell me that the tort time line is not governed by that two-year statute or it was tolled or began to run late, but you'll address all of that?

MR. MARRIOTT: Absolutely, Your Honor.

Four, they say that the allegation -- four, the claim should be dismissed, Your Honor, because they can't establish it as required bad faith. Finally, they can't prove damages sufficient to support a claim. Let me come to the first of these points. The evidence simply doesn't support in this instance a cause of action for unfair competition. That is true, Your Honor, for three reasons. Utah law and New York law limit the cause of action for unfair competition.

THE COURT: Which apply?

MR. MARRIOTT: We believe, Your Honor, that New York law applies. We set the reasons for that out in our opening papers, and there is a limitation provision in the joint development agreement between IBM and Santa Cruz that says that any allegation or breach -- any claim or action

related to a breach of the JDA is governed by New York law.

In any event, Your Honor, SCO contends that there is no meaningful, material difference between the law of New York and the law of Utah. We respectfully submit that under either law, SCO's claim for unfair competition fails.

Now, I have shown at tabs five and six of the book, Judge, under New York and Utah law a claim for unfair competition is a claim based on misappropriation and palming off. The Tenth Circuit affirmed the ruling of this Court in Proctor & Gamble saying that. In the Klein–Becker case, Judge Cassell likewise declined to extend the claim for unfair competition beyond misappropriation and palming off. There are more cases to be sure, but ––

THE COURT: That Proctor & Gamble case brings back so many happy memories.

Excuse me. Go ahead.

MR. MARRIOTT: There are many more cases, Your Honor, under New York law than there are under Utah law. The are roughly 15 cases, less than 15 cases in Utah law, and not a single one of them extends the law in the way SCO proposes here. There are more cases under New York law, Your Honor, but at the end of the day the essence of a claim for unfair competition under New York law is misappropriation or palming off.

At tab six of the book you'll see, for example,

the Dow Jones case out of the Second Circuit where that court said, quote, in order to succeed on their misappropriation and unfair competition claims, plaintiffs must establish some wrongful appropriation or use of plaintiff's intellectual property.

Likewise Judge, in the Eagle Comtronics case, the New York Appellate Division said that bad faith, misappropriation is an essential element, the gravamen the court said, of a claim for unfair competition.

Now, SCO seeks to expand, Your Honor, a claim for unfair competition under either state law by arguing that any form of commercial immorality is sufficient. But SCO cites only four cases in support of that proposition. Two of them, Your Honor, are misappropriation/palming off cases and they, therefore, do not support the proposition for which they are offered. The other two cases admittedly, Your Honor, contain broad language. However, those cases we would respectfully submit contrary to the weight of authority under New York law.

For example, the Ruder & Finn case from the Court of Appeals of New York said, and I quote, misappropriation of another's commercial advantage, and this is at tab seven, is a cornerstone of the court of unfair competition. Likewise, in the Czech Beer case out of the Southern District of New York, the Court there said that the essence

of unfair competition is that the defendant in bad faith has misappropriated the labors and the expenditures of another.

If you look back at the early tab in the book, SCO's paragraph 184-A, only that allegation of misappropriation could potentially state a claim for unfair competition under either New York or Utah law. Any such claim fails here, Your Honor, because the essence of the allegation is that IBM took code from Monterey and put it into its AIX for Power product. That, fundamentally, Your Honor, is linked to the contract here. Any claim or effort to turn a cause of action for breach of contract into tort is, we respectfully submit, barred by the rule that precludes doing just that.

If you look, Your Honor, at tab eight of our book, you will see cases making clear that a claim for breach of contract is not an adequate basis for the creation of a tort unless there is a separate duty involved. Here, Your Honor, the taking of code from project Monterey and putting it into the AIX for Power product went to the terms and conditions of the joint --

THE COURT: You say if that is anything it is a breach of contract?

MR. MARRIOTT: Correct, Your Honor.

The allegation is that IBM obtained the code in excess of the rights provided it under the joint development

agreement, and that it used that code in violation of its obligation to SCO. Those rights and those obligations are governed by the joint development agreement and, as a result, this claim, the misappropriated claim, the only form of the claim that should survive is barred under the independent tort doctrine.

Likewise, Your Honor, the joint development agreement includes a provision that says that neither party may assign or otherwise transfer its rights or delegate its duties without the prior written consent of the other party. In this case IBM did not consent to the transfer in question and, as a result, any claim that is based upon rights or obligations related to the JDA is a claim that can't be brought under that provision.

THE COURT: Now, what about the argument that the JDA may have prohibited the assignment of contract rights, but didn't prohibit the assignment of litigation rights?

MR. MARRIOTT: SCO raises that argument in its opposition papers, and it points to an assignment as between Santa Cruz and Caldera. The assignment on its face purports to transfer certain rights and not transfer other rights. Among the excluded rights, i.e., those not transferred, are any rights that Santa Cruz lacks the authority to transfer. That is point one.

Point two, Your Honor, is that the assignment by

its terms relates to intellectual property. Nowhere in any of the three schedules to that agreement will you find references made to the transfer of rights to sue or to bring claims that fundamentally depend upon an alleged breach of the JDA. Again, the claim is that we are exceeding the rights that we were granted under the JDA.

That, Your Honor, brings me to the second point, if I may.

THE COURT: Go ahead.

MR. MARRIOTT: The claim at issue here is preempted.

THE COURT: Preempted by the copyright law?

MR. MARRIOTT: Correct, Your Honor.

Again, the only aspect here that could represent unfair competition is the alleged misappropriation. Claims based upon misappropriation are preempted under federal law as we illustrate at tab 22 of the book. For example, Your Honor, the Tenth Circuit in the Ehat versus Tanner case held that unfair competition claims based on misappropriation are preempted.

Likewise, in Warner Brothers versus American Broadcasting Corporation case, 1983, out of the Second Circuit, the court held, quote, state law claims that rely upon the misappropriation branch of unfair competition are preempted. Other cases are to the same effect.

Now, what SCO argues, Your Honor, is that its claims here are not preempted because, and this is out of its paper at page 51, quote, SCO's unfair competition claim focuses on IBM's fraudulent and deceptive breaches of its fiduciary duty and confidentiality duties, close quote. The idea seems to be, Your Honor, that because SCO has alleged in its complaint and purports to have put forward evidence of a breach of a fiduciary duty, that that somehow insulates SCO's allegations of unfair competition relating to misappropriation from a finding of preemption. That, Your Honor, respectfully is wrong.

As is laid out in the cases at tab 23 of our book, the law is, and this is now quoting the Harold's Stores case from the Tenth Circuit, that a state cause of action requires an extra element -- only if it requires an extra element beyond mere copying, preparation of derivative works, and so on, only then will the claim be preempted.

The Titan Sports case out of the District of Connecticut put it this way: If the state cause of action requires the plaintiff to prove an extra element that changes the nature of the action so that it is qualitatively different from copyright infringement, it is not preempted. Only then is it not preempted.

In this case neither New York law nor Utah law requires an extra element of the sort necessary to result in

preemption. Now, SCO cites not a single case for the proposition that the extra element test here would result in preemption. In fact, Your Honor, SCO admits at page 34 of its opposition papers that a breach is not an essential or even an ordinary element of an unfair competition claim.

Courts have repeatedly found that a claim based on unfair competition of the misappropriation sort, and these cases are at tab 24 of the book, require an extra element. Therefore, in this case SCO's claim of no preemption fails.

Court's have, in fact, rejected, Your Honor, the exact argument that SCO makes here. Judge Cole, Your Honor, in the Southern District of New York in a decision earlier this year rejected the exact argument that SCO makes here. I refer Your Honor to tab 25. Judge Cole said, quote, the plaintiff argues that its unfair competition claim also contains elements of fraud, misrepresentation, breach of confidence, or other unethical conduct that create extra elements that differentiate this claim from copyright infringement.

However, those allegations are not elements of the claim of unfair competition based on copying the plaintiff's materials and, thus, do not prevent the finding of preemption.

SCO relies on four cases, Your Honor -- five cases, excuse me -- to support its argument that there is no

preemption here. Those five cases are as follows. Four of them are trade secret misappropriation cases. Courts take a different view as to trade secret misappropriation. The fifth and final case cited in their papers, Your Honor, is a case from the District of Kansas. That case did not apply to Utah. It did not apply to New York law. The case also involved allegations of palming off or passing off, which courts separately hold is not preempted, and to the extent, Your Honor, that the case suggests that an unfair competition claim based on misappropriation is in fact not preempted, respectfully, the decision is mistaken.

What makes those claims for breach of contract, Your Honor, the claim being that because there is a supposed breach of contract or fiduciary duty here that somehow there is not preemption, what makes that particularly baseless, Your Honor, is that, as I said at the outset, the claim that is at issue, the supposed misappropriation, is the exact same claim that SCO endeavored to include in the case as a copyright infringement case and that Your Honor said SCO could not include in the case as a copyright infringement case. I would refer Your Honor, respectfully, to the proposed third amended complaint, where you will read the exact type of alleged misconduct that is now at issue in this unfair competition claim.

Your Honor, the next reason why SCO’s claim for

unfair competition fails is that it is untimely. I will endeavor in this connection to answer Your Honor's questions about the arguments raised by SCO.

As a predicate, Your Honor, the claim is untimely because the joint development agreement between IBM and Santa Cruz included a provision which contained a two-year limitation provision that said that all suits related to a breach of the agreement had to be brought within two years. We submit that there is no reasonable dispute that the claim here relates to a breach of the joint development agreement. We have illustrated that at tabs 29 and 30.

If that is the case, Your Honor, the claims were not, as is further illustrated at 31 and 32, brought in a timely way. Contrary to SCO's suggestions, courts can and do uphold agreements of parties to limit and to shorten the limitation period, and have routinely construed provisions just like the provision in the joint development agreement here, as sufficient to narrow the statute of limitations.

Now, SCO makes two main arguments as to why it is that the statute of limitations -- the limitations period, I should say, Your Honor, somehow does not apply to it. The first of those concerns a so-called continuing violation. The second of those concerns allegations of concealment. Let me take the continuing violation allegation first, Your Honor. It is our view that Section 22.3 of the JDA, Your

Honor, provides the period of limitation and the period of accrual. It provides that a cause of action related to a breach must be brought within two years of the breach, in effect, trumping the so-called common law continuing violation rule.

In any event, Your Honor, while courts are not in harmony on the question, we have cited to the Court in our papers decisions from courts in which unfair competition claims based upon misappropriation are found not to represent continuing violations. The Opals case, for example. Those are at tab 37 of the book.

Finally, Your Honor, even if continuing violations were theoretically the right rule here, I would respectfully submit that it has no application to the particular claim that SCO submits for two reasons, Your Honor. First, the allegation, again, is that IBM improperly took code from Monterey and put into Power. By SCO's own admission, that occurred in 2000. That is a discrete event, Your Honor, the taking of the code and putting it into its own AIX for Power product.

To the extent IBM continues to use the code in its distribution of its AIX operating system, that merely underscores, Your Honor, that the claim at issue is really an unfair competition -- it is really an unfair competition claim seeking to be included by the back door, allegations

of copyright infringement that can't properly be brought.

Now, with respect to SCO's second argument of concealment, Your Honor, the allegation is that IBM improperly concealed from SCO that it intended to include in its AIX for Power product the code that is at issue. Your Honor, the documents that we have laid out in our papers, the documents that appear and are cited at tabs 39 through 41, make it clear that the parties agreed and understood from the beginning of the Monterey project that IBM would take code from System V, release four, and among other things include that in its AIX for Power product.

We believe, Your Honor, that IBM had a license to do that. SCO takes a different view. The fact of the matter, however, Your Honor, is that IBM told Santa Cruz, in addition to the fact that the agreement says exactly what it was going to do with respect to the code and, in fact, Santa Cruz and the head of the Santa Cruz UNIX business, Your Honor, has acknowledged that IBM told him and that he understood in 2000 that IBM took the code from Project Monterey and the agreement contemplated, and put it in the AIX for Power product.

Then, Your Honor, IBM announced the inclusion of the code publicly in its AIX for Power product. So any allegations of concealment we respectfully submit fail.

Now, the fourth reason, Your Honor, why we believe

SCO's claim for unfair competition fails is that it must in order to prevail on that claim demonstrate that IBM acted in bad faith. SCO endeavors to do that, Judge. It endeavors to do that by throwing charged language like deceptively obtained access, cover-up, scheme, sham product, spurious, fraud, theft and misuse. I would respectfully submit that those are nothing more than labels affixed by lawyers in an effort to avoid summary judgment.

At the end of the day, the only claim at issue is that we took code that could represent unfair competition, that we took code from Monterey and put it into AIX for Power. Again, the agreement contemplated that. We have laid out the documents that demonstrate that the parties intended that. At the end of the day the issue is whether that, Your Honor, represents bad faith.

SCO believes there is no license. IBM believe there is. There is a dispute as to the scope of the license. As we show in the cases at tab 44 of the book, a disagreement among parties as to the scope of a license does not represent bad faith. That is especially so, whereas here, if you look at tab 45 of the book you'll see that the joint development agreement expressly gave IBM a license to use the exact code that was used in its AIX for Power product.

Now, Your Honor, SCO alleges in an effort to

create the impression of bad faith that IBM took the code secretly -- its term is by clandestine action -- in a supposed effort to hide its sense of a wrong in doing that.

Well, as we explained to the Court, in opposing SCO's motion to amend the complaint to add a claim for copyright infringement, the documents make it perfectly clear that that is what was contemplated by the parties. Your Honor, when you decide SCO's motion to amend the complaint, observed that on the basis of those documents it appears, that SCO either knew or should have known prior to the commencement of this case that IBM had taken the code for Power and put it into its operating AIX system. The same evidence in which the Court relied, which demonstrates that SCO knew, in and around 2000, that IBM had done what it did in and around 2000.

Again, the head of the SCO unit division, Mr. McCrabb, at tab 47 of the book says as follows, quote: I was aware as early as 2000 that IBM incorporated UNIXWare/SVr4 code into AIX for Power. IBM made clear to us -- in fact, to the whole market, that it had included UNIX-Ware/SVr4 code in AIX for power. IBM publicly disclosed, Your Honor, that it did the very thing that SCO here contends was done in a clandestine fashion to hide IBM's bad faith. I would respectfully submit that no rational trier of fact could find that IBM acted in bad

faith by using code in a way the agreement expressly contemplated, that it told Santa Cruz it was going to use it, and that the head of the Santa Cruz division said he understood IBM was going to, and then IBM publicly disclosed that it did.

Finally, Your Honor, the fifth reason why the Court should enter summary judgment in favor of IBM on this claim is that SCO can't demonstrate damages as a result of the alleged misconduct. The proper measure of damages on a claim of this sort is lost profits sustained as a result of the alleged misconduct. We show that at tab 50.

As shown in 51, Your Honor, we asked SCO to describe its damages and SCO declined and said it would describe those damages in its expert reports. In its opposition papers, after we pointed out in our opening papers that SCO could not make out its claims, SCO points to the reports of three experts. Not a single one of those experts, Your Honor, offers competent evidence that the alleged unfair competition resulted in damages to SCO.

Finally, Your Honor, in summary, summary judgment here should be entered in favor of IBM on this claim, because the alleged misconduct doesn't amount to unfair competition, because it is preempted under federal copyright law, because it is untimely under the JDA, and because SCO can't demonstrate bad faith, and because SCO can't

demonstrate damages resulting from the alleged misconduct.

Thank you, Your Honor.

THE COURT: Thank you, Mr. Marriott.

Now, you all have to leave who are not cleared to view confidential documents. No one seems to be getting up.

(WHEREUPON, the confidentiality agreement was invoked.)

(Sealed portion not included.)