

Publisher*Steven Dresner***Executive Editor***Brett Goetschius***Managing Editor***Gregg S. Zukowski***Contributing Editors***Brendan Doherty**E. Kurt Kim**Susan Futterman**Michael Molinski***Research & Reporting***Daniel Lenchner***Production & Design***Ian Golder***Sales & Administration***Erica Straus***PIPEs REPORT**DealFlow Media, Inc.
P.O. Box 122

Syosset, NY 11791-0122

T: 516 364 8431

F: 516 364 8432

subscribe@dealflowmedia.com

www.dealflowmedia.com

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BAYSTAR, RBC AMEND SCO DEAL TERMS

BayStar Capital Management and **Royal Bank of Canada** have forced PIPE issuer **SCO Group** to amend the terms of a recent financing to give the investors veto power over any actions by the software firm that might trigger a controversial contingency fee agreement between the company and lawyers prosecuting a copyright infringement suit against **IBM**.

BayStar and RBC invested \$50 million in SCO in mid-October, enabling the company to proceed with the lawsuit that it originally filed in March. The investment came in the form of convertible preferred securities equivalent to a 17.5% stake in SCO. The securities were acquired at a conversion price of \$16.93 and represent, upon conversion, 2.95 million shares of SCO. The capital infusion boosted SCO's net cash position to \$61 million, compared with the approximately \$11 million the company reported for the period ended July 31.

Last week BayStar leaned on SCO and its lawyers—primarily **Boies, Schiller & Flexner**—and secured the right for the private investors to approve or veto actions by the company that would entitle its attorneys to a hefty 20% contingency fee Boies negotiated with SCO that can be triggered by a number of events including the sale of all or part of the company. The contingency agreement has been criticized as overreaching, particularly since revelations surfaced that Boies had hired the brother of SCO's chief executive, Darl McBride, as local co-counsel for the suit.

“SCO can do whatever it wants with respect to the ordinary course of business, or with the lawsuit. However, in the case of a sale or settlement, it has to bring us to the table,” explained Larry Goldfarb, managing partner of California-based BayStar. Under the newly renegotiated terms, investors in SCO's series A convertible preferred stock must approve any action that would trigger the contingency payment to Boies by a two-thirds super-majority. Kevin McBride, who heads a small private practice in Park City, Utah, recently appeared

in a Salt Lake courtroom to represent the company at a hearing in the suit. McBride reportedly has little intellectual law or corporate contract litigation experience. In the December 8 8K filing SCO revealed Kevin McBride's involvement and indicated the company's board has approved the arrangement.

Goldfarb insists that the pending lawsuit—or settlement—was not the only reason for the investment. “On the core business side, we liked the entire licensing business that SCO was creating. We liked the credit—they burned no debt, expenses are low. The PIPE structure that we put in place fit in well. And we liked the convertible structure and the way the dividends fit.”

Should SCO fail in its lawsuit, investors are still “pretty well protected,” he says. “Our investors are in a very good position in that their downside is protected. We can redeem the note and get our money back in stock and cash.” Subsequent to announcing the new terms in an amended filing of its 8K, SCO delayed its earnings release and investor conference call, originally set for December 8, to December 22 so it could determine how the transaction should be treated for accounting purposes.

Funded largely by BayStar and RBC's investment, SCO is prosecuting a widely publicized \$3 billion lawsuit against IBM—and by proxy much of the IT industry. SCO is alleging that the computer giant illegally incorporated Unix software code, which SCO owns rights to, into the open-source Linux operating system. IBM has denied the allegations and countersued.

The SCO lawsuit is slated to go to trial in a Utah federal court in April 2005. The court, however, recently ordered SCO to provide detailed information regarding the company's claims that IBM violated its contract; in addition, the judge suspended all discovery motions until SCO provides that information. Until SCO complies, the lawsuit effectively is stalled. ■