

SCO's Legal Fees Could Jeopardize Its Software Business

George J. Weiss

The SCO Group will pay its lawyers \$9 million to pursue lawsuits against Linux users. Linux users should keep a low profile and have a contingency plan. SCO customers should have a migration plan in case SCO's legal strategy falters.

NEWS ANALYSIS

Event

On 18 November 2003, SCO announced that it would pay \$1 million and issue shares worth \$7.95 million to Boies, Schiller & Flexner. This law firm represents SCO in its lawsuits against companies using Linux in alleged violation of SCO's intellectual property rights.

Analysis

Mounting financial pressures have forced SCO to find alternatives to pay Boies, Schiller & Flexner. SCO not only faces the litigation against IBM (scheduled for April 2005) but must also defend counterclaims by Red Hat and IBM. Moreover, after threatening 1,500 Linux users for infringing its intellectual property rights, SCO has declared that within 90 days (or by about February 2004) it will start litigation against one or more Fortune 500 companies with large Linux installations.

SCO has declared in filings with the U.S. Securities and Exchange Commission that its competitive position could decline if the company can't obtain additional financing. The latest share issue will dilute shareholders' investments about 3.5 percent. It comes on top of a previously announced arrangement giving Boies, Schiller & Flexner a 20-percent share in SCO if the company were sold. SCO also received an investment of \$50 million from BayStar Capital in return for 17.5 percent of outstanding shares. We believe that these moves compromise SCO's mission as a software company. Increasingly, the legal and financial aspects of the intellectual property infringement cases will absorb the company's attention, and a law firm will be in an increasingly powerful position to set the overall agenda for its compensation. Therefore, SCO will likely pursue claims against Linux users quickly. Its degree of success will determine the vendor's financial health.

Recommendations:

- Keep a low profile and do not divulge details on Linux deployments.
- Until a judgment in a case would unequivocally warrant it, Linux users should not pay SCO the license fees it has asked for to settle its allegations of infringement of intellectual property rights.
- Do not permit SCO to audit your premises without legal authorization.
- Your legal counsel should monitor developments and understand the infringement claims.
- Pressure high-profile Linux vendors to contractually guarantee against infringement claims by covering court costs. Evaluate Hewlett-Packard's willingness to indemnify Linux customers.
- Fence off the innocuous Linux deployments (such as network-edge solutions) from the performance-intensive ones. Where feasible, delay deployment of high-performance systems until the end of 1Q04 to see what SCO will do.
- If high-performance Linux systems are in production, develop plans that would enable a quick changeover in case SCO wins a favorable judgment and requires the Linux kernel code to be substantially changed. Unix systems are the best alternatives.

- For customers of SCO Open Server and UnixWare, an *unfavorable* judgment could cause SCO to cease operations or sell itself. That could harm future support and maintenance. Just in case, prepare a plan for migrating to another platform within two years.

Analytical Source: George Weiss, Gartner Research

Recommended Reading and Related Research

- "HP and Linux Users Will Benefit From Legal Indemnity Offer" — The offer to pay the legal expenses of Linux customers sued by SCO for infringing its intellectual-property rights sets Hewlett-Packard apart from other major vendors. **By George Weiss**
- "IBM, Red Hat Lawsuits Will Put Financial Pressure on SCO" — Enterprises with large future Linux commitments should avoid paying SCO's server license fees because they appear arbitrarily high, represent a concession to SCO's claims and will expose the customers to ever-larger license fees. **By George Weiss**

(You may need to sign in or be a Gartner client to access all of this content.)

REGIONAL HEADQUARTERS

Corporate Headquarters
56 Top Gallant Road
Stamford, CT 06902-7700
U.S.A.
+1 203 964 0096

European Headquarters
Tamesis
The Glanty
Egham
Surrey, TW20 9AW
UNITED KINGDOM
+44 1784 431611

Asia/Pacific Headquarters
Level 7, 40 Miller Street
North Sydney
New South Wales 2060
AUSTRALIA
+61 2 9459 4600

Latin America Headquarters
Av. das Nações Unidas 12.551
9 andar—WTC
04578-903 São Paulo SP
BRAZIL
+55 11 3443 1509