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Controlling Patent Trolls

*'eBay' decision limits strategic advantages for businesses
that own and license merely for fees.*

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IN RECENT YEARS, there has been a dramatic rise in the amount of patent litigation filed in the United States. One of the causes for the increase in litigation is a new business model known as the "patent troll." The term "patent troll" was coined several years ago by Peter Detkin, then assistant general counsel at Intel Corp., to describe people who "try to make a lot of money off a patent they are not using and have no intention of using."¹ Four justices of the U.S. Supreme Court recently referred to the business as "firms [that] use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees."² There is currently a booming market for companies and individuals buying patents from distressed businesses, demanding license fees for alleged infringement, and suing companies that refuse to pay up.

Typically, the patent troll's infringement accusations will be accompanied by threats of legal action and permanent injunctions. Patent trolls, however, invariably offer the accused infringer an easy way out—namely, an offer to license the patented process for much less than the actual cost of defending the litigation. Thus, patent trolls make threats of litigation that can be made to go away by the mere expedient of agreeing to a license for the nuisance value of the threatened lawsuit, perhaps with a premium to account for the potential risks associated with such litigation.

Prior to the Supreme Court's decision last year in *eBay Inc. v. MercExchange, L.L.C.*,³ the U.S. Court of Appeals for the Federal Circuit's jurisprudence unwittingly provided patent trolls with at least two strategic advantages that enhanced their ability to extract licensing agreements from their targets. First, the Federal Circuit has long held, as a general rule, that permanent injunctions are to be granted upon a finding of patent infringement, except in the rarest

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of cases. It thus was exceedingly easy for patent trolls to threaten that, if their target is deemed an actual infringer, the court would most assuredly enter a permanent injunction against future infringement.

Second, beginning with *Red Wing Shoe Company, Inc. v. Hockerson-Halberstadt, Inc.*,⁴ decided in 1998, the Federal Circuit has established a personal jurisdiction jurisprudence that virtually assures that a true patent troll—i.e., one that has no business other than owning and licensing patents—will be deemed subject to personal jurisdiction only in its home forum. This Federal

Circuit jurisprudence provides patent trolls with the comfort of knowing that they will not be haled into court in some far off, inconvenient jurisdiction, even after sending threatening letters into that jurisdiction, and thus secures for them a permanent, home field advantage.

The Supreme Court's *eBay* decision, however, removes these advantages, explicitly with respect to the first issue and by implication with respect to the second. While much has been written about the *eBay* decision's effect on the granting of permanent injunctions, the effect of the *eBay* decision on the Federal Circuit's personal jurisdiction jurisprudence has received little notice.

Threat of Permanent Injunctions

In many instances, the threat of a permanent injunction poses an enormous risk, even when the target believes that it is not infringing. A permanent injunction, of course, could have devastating consequences for a company. For example, an infringing company may be required to expend significant sums to overhaul its technology or, more drastically, may be put entirely out of business. Thus, as Justice Anthony M. Kennedy has recognized, for patent trolls, "an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent."⁵ This is so even when "the patented invention is but a small component of the product the compan[y] seeks to produce [or utilize]."⁶ Faced with the possible risks, however slight, and litigation that will cost a substantial sum, the alleged infringer may be willing simply to pay for a license at a nuisance value.

By agreeing to license the patent—which it may or may not actually be infringing—the alleged infringer avoids any risk, while at the same time paying less than it likely would cost to litigate the issue. From that perspective, entering into a license agreement poses a practical, "no lose" prospect for the alleged infringer (except that when an alleged infringer surrenders to one patent troll, it signals to the market that it is likely to surrender to the demands of the next patent troll that makes a threat).

Home Field Advantage

The Federal Circuit's personal jurisdiction jurisprudence affords patent trolls the knowledge that any litigation involving its efforts to extort license payments necessarily will occur in their convenient home forum. Put differently, patent trolls know that their target may have to litigate across the country, thus making the potential litigation even more inconvenient and more expensive for the target and increasing the likelihood that the target will agree to pay for a license (perhaps even at a premium) to avoid the inconvenience and expense.

The lesson of 'eBay' is simply that the same law applies to patent holders as applies to everyone else and that not all patent holders or patent cases are the same.

End to Automatic Injunctions

The Supreme Court's May 2006 *eBay* decision explicitly eliminates the concept of automatic injunctions in patent cases. In *eBay*, the jury found that *eBay* and a subsidiary infringed a patent belonging to MercExchange, and that monetary damages were appropriate to remedy the infringement.⁷ The district court denied MercExchange's motion for a permanent injunction.⁸ On appeal, the Federal Circuit reversed the district court's denial of the motion for a permanent injunction, "applying its 'general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances.'"⁹ The Supreme Court granted certiorari "to determine the appropriateness of this general rule."¹⁰

In addressing this issue, the Supreme Court undertook a rather straightforward analysis, comparing the Federal Circuit's general rule with the traditional, four-factor test applicable to requests for equitable relief. The Supreme Court noted that, when seeking a permanent injunction, a plaintiff traditionally must demonstrate that (1) it suffered an irreparable injury; (2) remedies available at law, like money damages, are inadequate to compensate for the injury; (3) considering the balance of hardships between plaintiff and defendant, a remedy in equity is warranted; and (4) the public interest would not be disserved by a permanent injunction.

Furthermore, the Supreme Court noted that a district court may grant or deny such relief in the exercise of its discretion.¹¹ The Supreme Court contrasted the Federal Circuit's general rule, "unique to patent disputes, 'that a permanent injunction will issue once infringement and validity have been adjudged'" and that "injunctions should be denied only in the 'unusual' case, under 'exceptional circumstances' and 'in rare

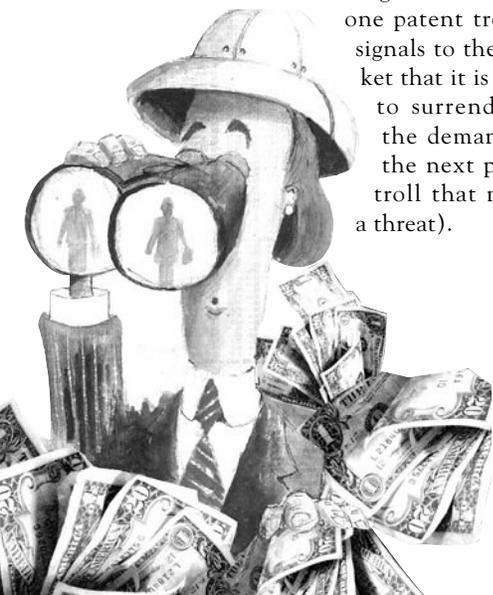
instances...to protect the public interest."¹²

There can be no question that the Federal Circuit's "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances" deviates from the traditional four-factor test. The question for the Supreme Court, therefore, was whether there is any appropriate basis for treating patent cases differently than all other cases. The Supreme Court answered that question in the negative, finding that traditional equitable principles "apply with equal force to disputes arising under the Patent Act...[and that] [n]othing in the Patent Act indicates that Congress intended [] a departure" from the traditional four-factor test.¹³ The Supreme Court thus concluded that the traditional, discretionary four-factor test for granting equitable relief applies "in patent disputes no less than in other cases governed by such standards."¹⁴

Thus, with the stroke of a pen, the Supreme Court eliminated one of a patent troll's most significant weapons—the threat of a virtually automatic permanent injunction upon a finding of infringement. As a practical matter, the *eBay* decision did more than just that. Now that the Supreme Court has returned discretion to trial courts, it likely will be very difficult for patent trolls to obtain permanent injunctions against companies that infringe their patents. This is so because the realities of the patent trolls' business model suggest that they rarely, if ever, will be irreparably harmed by the infringement. Justice Kennedy's concurring opinion explains as much, noting that when "the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest."¹⁵

Put differently, if a patent troll is in the business of licensing its patents for a fee—rather than actually practicing them—it is unlikely that it will be able to demonstrate that infringement irreparably harms it. This is so, of course, because the existence of licenses demonstrates (or at least suggests) that a patent troll typically can be made whole by a damages award. The district court in *eBay* subscribed to this logic: "plaintiff's willingness to license its patents' and 'its lack of commercial activity in practicing the patents' would be sufficient to establish that the patent holder would not suffer irreparable harm if an injunction did not issue."¹⁶ The Supreme Court admonished the district court's adoption of such a broad principle, which suggested that "injunctive relief could not issue in a broad swath of cases," but the Supreme Court did not state any objection to the district court's logic generally.¹⁷

The Supreme Court thus admonished the district court for expounding a broad rule preventing the grant of injunctive relief in a whole category of cases, and the circuit court for expounding a broad rule requiring the grant of injunctive relief in a whole category of cases. The Supreme Court's lesson should be clear: Broad rules are inappropriate where the ultimate issue



should be decided on a case-by-case basis.

Jurisdiction Jurisprudence

In courts throughout the country, in cases not involving patents, judges engage in fact-specific analyses concerning the extent of a defendant's jurisdictional contacts, and whether those jurisdictional contacts, in the circumstances of that case, satisfy due process. Broadly speaking, when a defendant's contacts with a forum are continuous and substantial, a court may exercise general jurisdiction over it, even if the cause of action is entirely unrelated to any of the jurisdictional contacts. Additionally, where the defendant does not have sufficient contacts with a forum to justify the exercise of general jurisdiction, the court can exercise specific jurisdiction when the defendant engaged in purposeful activities in the forum with respect to the conduct that gives rise to the complaint, as long as the exercise of jurisdiction would not offend due process. As *Red Wing* states, "Even a single contact with a forum state may suffice for personal jurisdiction if it is directly and substantially related to the plaintiff's claim."¹⁸ But nonetheless, the Federal Circuit's *Red Wing* decision and its progeny set forth a broad-based exception to generally accepted principles of personal jurisdiction jurisprudence.

In *Red Wing*, HHI, a patent holder incorporated in Louisiana with a principal place of business in New Mexico, sent a letter to Red Wing in Minnesota, claiming that Red Wing was infringing HHI's patent and offering to negotiate a license. HHI sent to Red Wing a second letter alleging infringement, and then a third letter, again claiming that Red Wing was infringing its patent and again offering a license. Red Wing refused to pay for a license, instead filing a declaratory judgment action against HHI, which moved to dismiss for lack of jurisdiction.

Red Wing attempted to establish jurisdictional contacts with the forum state, Minnesota, other than the three letters it received from HHI. Ultimately, however, the only jurisdictional contacts of importance were HHI's three letters to Red Wing in Minnesota. Red Wing thus argued that, because it filed the declaratory judgment action as a result of receiving the letters sent by HHI to it in Minnesota, HHI was subject to specific jurisdiction. The *Red Wing* court disagreed.

While the *Red Wing* court acknowledged that HHI's letters—i.e., the cease and desist letters—"at least partially give rise to the plaintiff's action,"¹⁹ the court concluded that subjecting HHI to jurisdiction would not comport with due process. The court reasoned:

Principles of fair play and substantial justice afford a patentee sufficient latitude to inform others of its patent rights without subjecting it to jurisdiction in a foreign forum. A patentee should not subject itself to personal jurisdiction in a forum solely by informing a party who happens to be located there of suspected infringement.²⁰

The *Red Wing* court then made the kind of broad pronouncement that the Supreme Court found objectionable in *eBay*, stating: "Specifically, such letters cannot satisfy the second prong of the Due Process inquiry." Thus, with that one statement, patent trolls became free to send threatening letters all over the country without any risk of being hailed into far off courts.

In a subsequent case, *Silent Drive, Inc. v. Strong Industries Inc.*,²¹ the Federal Circuit expounded upon the basis for its prior holding in *Red Wing*. The court first noted that, "[b]ecause the issue of personal jurisdiction in a declaratory action for patent invalidity and non-infringement is intimately related to patent law, personal jurisdiction... is governed by the law of this circuit."²² Then, the Federal Circuit explained, as it had in its *eBay* decision, that the law simply is different in patent cases: "In this circuit, we have repeatedly held that the sending of infringement letters would satisfy the minimum contacts requirement of due process except for policy considerations unique to the patent context."²³

Lesson of 'eBay'

Though directed toward equitable remedies, the *eBay* decision sets forth two general pronouncements that should apply equally to the Federal Circuit's personal jurisdiction jurisprudence. Accordingly, as shown below, the *eBay* decision implicitly overrules the Federal Circuit's personal jurisdiction jurisprudence.

The *eBay* decision instructs that: (1) it is not appropriate for courts to set forth broad, categorical rules about issues that usually require a case-by-case factual analysis; and (2) the Patent Act does not change long-standing jurisprudence unless explicitly stated. In one sentence in its earlier decision in *Silent Drive*—"In this circuit, we have repeatedly held that the sending of infringement letters would satisfy the minimum contacts requirement of due process except for policy considerations unique to the patent context"—the Federal Circuit contravenes both of these teachings, which thus calls into question the continued validity of the Federal Circuit's personal jurisdiction jurisprudence.

But just as in *eBay*, which acknowledges that, based entirely on the facts before it, there are cases where it would be appropriate for a district court to grant a permanent injunction, and cases where it would not, there similarly are cases where it would be reasonable to hail a patent holder into court in a foreign forum for sending a cease and desist letter, and cases where it would not. Thus, for example, it may be inappropriate to hail a professor who lives in New York before a court in Hawaii simply because the professor sends a letter to Hawaii demanding that someone stop infringing her patented technology. But, by contrast, entirely different considerations might apply where, instead of by a professor, the cease-and-desist letters are sent by a company whose sole basis for existing is to

try to obtain licenses for patents that may or may not even be infringed.

The lesson of *eBay* is simply that the same law applies to patent holders as applies to everyone else and that not all patent holders or patent cases are the same. *Red Wing* recognized the importance of the right of an accused infringer to bring a declaratory judgment action to disentangle a non-infringing business from an inapplicable patent claim. A special jurisdictional rule for patent cases frustrates this significant purpose. Accordingly, it would seem appropriate for courts to evaluate jurisdiction in relation to the specific case before it, and not based on a categorical rule that may or may not actually make sense based on the facts of a particular case.

Conclusion

The time has come to test the continued validity of the categorical approach to jurisdiction espoused by *Red Wing* and its progeny. Only by getting the issue back before the Federal Circuit, particularly in light of the teachings of *eBay*, will the Federal Circuit revisit its categorical holding, based on its conception of policy considerations unique to patents, that patent holders cannot be subject to jurisdiction in a foreign forum merely by sending cease-and-desist letters.



1. Brenda Sandburg, "A Modest Proposal," THE RECORDER, May 5, 2005, at 1.
2. *eBay Inc. v. MercExchange, L.L.C.*, 126 S.Ct. 1837, 1842 (2006) (Kennedy, J., concurring).
3. *eBay Inc. v. MercExchange, L.L.C.*, 126 S.Ct. 1837 (2006).
4. *Red Wing Shoe Company, Inc. v. Hockerson-Halberstadt, Inc.*, 148 F.3d 1355 (Fed. Cir. 1998).
5. *eBay*, 126 S.Ct. at 1842 (Kennedy, J., concurring).
6. Id.
7. Id. at 1839.
8. Id.
9. Id. (citing *eBay*, 401 F.3d 1323, 1339 (Fed. Cir. 2005)).
10. Id. (citing *eBay Inc. v. MercExchange, L.L.C.*, 126 S.Ct. 733 (2005)).
11. Id.
12. Id. at 1841 (citing *eBay*, 401 F.3d at 1338-39).
13. Id. at 1839.
14. Id. at 1841.
15. Id. at 1842 (Kennedy, J., concurring).
16. Id. at 1840 (citation omitted).
17. Id.
18. *Red Wing*, 148 F.3d at 1359.
19. Id. at 1360.
20. Id. at 1360-61.
21. *Silent Drive, Inc. v. Strong Industries Inc.*, 326 F.3d 1194 (Fed. Cir. 2003).
22. Id. at 1201.
23. Id. at 1206.