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INTELLECTUAL PROPERTY

Attorneys James R. Klaiber and Bradley S. Friedman of Milbank, Tweed, Hadley & McCloy, New York, review two recent cases testing whether the intellectual property infringement lawsuits in the International Trade Commission are exempt from the automatic stay provisions of the Bankruptcy Code.

International Trade Commission Intellectual Property Investigations: An Exception to the Bankruptcy Code's Automatic Stay?



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I. Introduction

In two recent cases, *In re Qimonda* and *In re Spanion*, bankruptcy courts were asked to determine whether International Trade Commission investigations, a regulatory enforcement action often strategi-

cally and contemporaneously brought with a private intellectual property infringement suit, are exempted from the automatic stay provisions of the U.S. Bankruptcy Code. In both cases, the bankruptcy courts held that the automatic stay did apply to ITC investigations involving the importation of goods that allegedly infringed on otherwise valid U.S. patents. However, on

appeal, each of the respective district courts overturned those holdings, one on the merits and the other as moot.

These decisions, and the arguments of the parties, provide insight into how to strategically prepare or continue patent-related litigation when confronted with defendants that file for bankruptcy protection in the United States.

II. The Bankruptcy Code's Automatic Stay

Perhaps the most prominent protection provided to a debtor in a bankruptcy case is what is commonly known as the automatic stay. Section 362 of the Bankruptcy Code provides that upon the filing of a bankruptcy petition—the document that a debtor files to initiate a bankruptcy case—the debtor's estate and the debtor are automatically protected from, among other things, the commencement or continuation of suits on prepetition claims and from lien enforcement.¹ In particular, the actions that are subject to the automatic stay include, among other things: (a) a judicial or administrative action or proceeding against the debtor that was or could have been commenced before the filing for bankruptcy; (b) the enforcement, against the debtor or against the property of the debtor's estate, of a judgment obtained before the filing for bankruptcy; (c) any act to obtain possession of property of the estate or to exercise control over the property of the estate; and (d) any act to create, perfect, or enforce a lien against property of the debtor's estate.²

While the list of acts subject to the automatic stay is broad, the Bankruptcy Code expressly provides exceptions to and safe harbors from the automatic stay.³ One of the enumerated exemptions relates to proceedings by a "governmental unit" to enforce its "police and regulatory power."⁴ Under this "Police Powers Exception" a governmental unit may pursue certain actions against the debtor or the estate, but it may not enforce a money judgment or seize or seek control over property of the estate without first obtaining relief from the stay.⁵

In determining whether an action is covered by the Police Powers Exception, courts have developed two tests: (a) the pecuniary purpose test, which asks whether the governmental unit is pursuing a matter of public safety and welfare as opposed to a governmental pecuniary interest; and (b) the public policy test, which

¹ See 11 U.S.C. § 362(a).

² *Id.* The listed actions that are subject to the automatic stay are as follows: the commencement of a claim that arose or could have been brought against the debtor before the filing of the bankruptcy petition ((a)(1)); enforcement of a judgment (against the debtor or the estate's property) issued before the petition ((a)(2)); acts to "obtain possession" of property of the estate, or to "exercise control" over such property ((a)(3)); acts to create, perfect, or enforce liens against such property ((a)(4)); acts to create, perfect, or enforce liens against the debtor's property to secure claims arising before the petition ((a)(5)); acts to recover a claim against the debtor arising before the petition ((a)(6)); setoff of debt owing to the debtor arising before the petition ((a)(7)); and proceedings before the U.S. Tax Court concerning either a corporate or individual debtor's tax liability ((a)(7)).

³ See generally 11 U.S.C. § 362(b); *id.* at §§ 553, 555-557, 559-561.

⁴ 11 U.S.C. § 362 (b)(3).

⁵ Collier on Bankruptcy 362.05[5][a].

asks whether the government action is designed to effectuate a public policy rather than to adjudicate private rights.⁶

III. The ITC and Section 337 Actions

The ITC is an independent federal agency having broad investigative powers in matters of international trade. The ITC routinely conducts investigations of the impact of unfair trade practices, including subsidies, dumping, and the infringement of intellectual property rights, on U.S. commerce.

The ITC was originally formed in the early 20th century to police U.S. customs tariffs, but the Tariff Act of 1930 empowered the ITC to issue exclusion orders barring the importation of goods that violate the patent, copyright, or trademark rights of a U.S. entity having a domestic industry. An exclusion order is similar to an injunction against importation, but empowers the U.S. Customs personnel to stop the infringing goods from crossing U.S. borders.

Typically, an ITC investigation of IP infringement brought under Section 337 of the Tariff Act is instituted based on a complaint filed by the holder of such rights. The statute requires that an investigation should be completed at the "earliest practical time,"⁷ which usually means within 12 to 18 months after its institution. The ITC has recently become an increasingly popular forum for U.S.-based entities (and others with a significant U.S. presence) to enforce their IP rights against the manufacturers and importers of infringing goods, given the backlog of cases in many U.S. district courts.⁸

IV. *In re Qimonda*

A. Background

On April 18, 2008, LSI Corp., owner of U.S. Patent No. 5,227,335, filed a complaint with the ITC alleging that certain named respondents had imported into the United States infringing semiconductor integrated circuits using tungsten metallization in violation of Section 337 of the Tariff Act of 1930. Following a preliminary investigation, the ITC ordered a formal investigation of LSI's complaint on May 14, 2008. Thereafter, Qimonda AG ("Qimonda") was named as an additional respondent.

On June 15, 2009, Qimonda filed a petition for recognition of its pending German insolvency proceeding under Chapter 15 of the Bankruptcy Code.⁹ The U.S. Bankruptcy Court for the Eastern District of Virginia

⁶ *Berg v. Good Samaritan Hospital Inc. (In re Berg)*, 230 F.3d 1165 (9th Cir. 2000).

⁷ 19 U.S.C. § 1337 (b)(1).

⁸ The average number of Section 337 investigations in calendar years 2000-2004 was 21, compared to an average of 34 for 2005-2009. As of November 2010, there were already 52 investigations instituted. See http://www.usitc.gov/intellectual_property/documents/cy_337_institutions.pdf (retrieved Nov. 23, 2010); http://www.usitc.gov/press_room/337_stats.htm (retrieved Nov. 23, 2010).

⁹ For a brief overview of Chapter 15 and Qimonda's case see Blake Reese and Bradley S. Friedman, *Back to the Future (Lubrizol): Qimonda Bankruptcy Provides Debtors With a Windfall at the Expense of Their IP Licensees* (22 BBLR 316, 3/4/10), and *Back to the Future (Lubrizol) Part II: An Update on the Qimonda Bankruptcy* (22 BBLR 1101, 8/12/10).

entered an order granting Qimonda's petition on July 22, 2009 (the "Recognition Order"), at which time the Chapter 15 filing automatically stayed under Section 362(a) of the Bankruptcy Code all pending U.S. litigation, including the ITC investigation against Qimonda.¹⁰

On July 13, 2009, LSI filed a notice of appeal of the court's order granting Qimonda's Chapter 15 petition. In mid-July, both LSI and the ITC also filed an objection to entry of the Recognition Order. On Feb. 16, 2010, the bankruptcy court rejected the ITC's argument that a Section 337 investigation is exempt from an automatic stay, holding that the police and regulatory exception under Section 362(b)(4) of the Bankruptcy Code was inapplicable to an ITC investigation.

Rather, the bankruptcy court held that no exceptions to the automatic stay applied because (i) LSI, and not the ITC, controlled the litigation, and (ii) the remedy sought in the ITC proceeding—preventing infringing articles from being imported in the United States—was not a sufficient public policy under the police or regulatory power exception.

The ITC filed a timely notice of appeal on Feb. 26, 2010.¹¹ Meanwhile, the ITC issued a final determination in March 26, 2010, finding that the '335 patent was invalid for obviousness.¹²

B. The ITC's Arguments

On appeal to the U.S. District Court for the Eastern District of Virginia, the ITC contended that a Section 337 proceeding qualifies as an exercise of "police and regulatory authority," and therefore, it is exempt from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. The ITC provided a broad overview of the statutory background to the Section 362(b)(4) exception and concluded that a Section 337 investigation is both (i) conducted by a governmental unit, and (ii) promotes an important public interest.

In particular, the ITC argued that although LSI, a private complainant, brought its allegations to the attention of the ITC, a formal Section 337 investigation can only be instituted by the ITC, a governmental unit, by a vote of the commissioners. Further, the ITC contended that a Section 337 investigation advances the important public interest of protecting U.S. industries from imports that infringe valid U.S. patents, which is independent of, and in addition to, any private rights afforded to patent holders.

C. Qimonda's Arguments

Qimonda argued that in light of the '335 patent's then-forthcoming expiration in July 2010, and the current liquidation of Qimonda's estate, the ITC's appeal would soon be moot and the appellate court should decline to consider it. In the alternative, Qimonda relied on and incorporated all arguments from its reply brief before the bankruptcy court, which argued that the au-

tomatic stay applied because LSI initiated the ITC investigation, the Section 337 proceeding was brought by a private individual rather than a governmental unit and benefited a single party rather than the general public.

D. Virginia District Court Decision

On June 28, 2010, Judge T.S. Ellis of the U.S. District Court for the Eastern District of Virginia issued an order overturning the bankruptcy court's decision.¹³ In reviewing the novel question of whether Section 362(b)(4) of the Bankruptcy Code operates to except a Section 337 proceeding from an automatic stay, the court determined that the bankruptcy court had erred in applying the automatic stay to the ITC's investigation because the ITC proceeding was an action brought by a governmental unit to enforce its police and regulatory power.

After providing a detailed synopsis of the statutory framework governing Section 337, Ellis determined that (i) the ITC is a federal agency created by Congress, and therefore qualifies as a governmental unit; (ii) the formal ITC investigation commenced only after the ITC determined that the LSI complaint warranted an investigation, and LSI's filing of the complaint did not transform the ITC investigation into an action by a private party; and (iii) the ITC's investigation vindicates a public interest because the ITC has no pecuniary interest in Qimonda's estate and the statutes and regulations governing a Section 337 investigation require the ITC and the president, in consultation with other agencies, to consider the effect an ITC determination will have on the public health, welfare, and competition.

V. *In re Spansion*

A. Background

In November 2008, Spansion, Inc. initiated parallel patent infringement actions in a federal district court and with the ITC against Samsung Electronics Co. Shortly thereafter, on Jan. 16, 2009, Samsung asserted patent infringement counterclaims against Spansion in the district court action.

Although Spansion later filed voluntary Chapter 11 and Chapter 15 petitions on March 1, 2009 and April 30, 2009, respectively, with the U.S. Bankruptcy Court for the District of Delaware, a bankruptcy court-approved stipulation modified the automatic stay, permitting Samsung to proceed with its pre-petition counterclaims. Despite the stipulation, Samsung withdrew its district court counterclaims and instead filed a new post-petition ITC action against Spansion for patent infringement on July 31, 2009.

Upon the filing of motions by various Spansion note-holders, on Oct. 1, 2009, the bankruptcy court issued orders staying Samsung's ITC action against Spansion, holding that the automatic stay applied. According to the bankruptcy court, none of the Section 362(b) exceptions applied.

Specifically, the bankruptcy court cited the *Qimonda* bankruptcy court's decision and held that the police and regulatory powers exception to the automatic stay under Section 362(b)(4) did not apply because the filing of the ITC complaint was purely for the benefit of Sam-

¹⁰ No. 09-14766-RGM, 2009 WL 2210771 (Bankr. E.D. Va. July 16, 2009), *rev'd*, *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).

¹¹ LSI was not a party to the ITC's appeal.

¹² See *In the Matter of Certain Semiconductor Integrated Circuits by Using Tungsten Metallization*, Inv. No. 337-TA-648, 73 Fed. Reg. 29534 (May 21, 2008). It thus appears that the ITC proceeded with its investigation without giving any effect to the bankruptcy court's order enforcing the automatic stay.

¹³ *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).

sung, and only incidentally serves the goal of protecting the public from unfair competition.

Both Samsung and the ITC filed separate briefs appealing the bankruptcy court's decision to stay the ITC action.

B. Spansion's Arguments

Spansion maintained that the ITC action was properly stayed because it would have violated both Sections 362(a)(1) and (3) of the Bankruptcy Code. First, Spansion pointed to Samsung's withdrawal of its pre-petition district court counterclaims as evidence that these same claims could have been commenced with the ITC prior to the bankruptcy under Section 362(a)(1).

Second, Spansion contended that the ITC action was an attempt by Samsung to exercise control over estate property under Section 362(a)(3) of the Bankruptcy Code. Although the nature of an ITC remedy is injunctive, Spansion asserted that if its goods were excluded from the U.S., the net effect would be adverse control over "the core business and property."

Following the reasoning in the *Qimonda* bankruptcy court's earlier opinion,¹⁴ Spansion contended that the ITC action was not a valid exercise of police or regulatory power and therefore was not exempt from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. Despite the fact that the ITC is a governmental entity, Spansion stressed that the ITC action could potentially benefit Samsung's private interests, and the ITC would merely be adjudicating private rights. Thus, Spansion concluded that the ITC is not an independent entity exercising police or regulatory power on behalf of the general public interest.

C. Arguments of Samsung and the ITC

Regarding Section 362(a)(1)'s application to pre-petition claims, Samsung argued that because patent infringement is a continuing tort, a separate cause of action accrues with each instance of infringement. By filing the ITC action on July 31, 2009, Samsung only purported to resolve post-petition claims occurring on and after that date, therefore falling outside of Section 362(a)(1).

Samsung further argued that the ITC action did not run afoul of Section 362(a)(3) of the Bankruptcy Code because injunctive relief in the form of an ITC exclusion order would not result in a monetary award to Samsung, nor allow it to gain possession of estate property. Similarly, this type of relief would not affect any Spansion products already in the United States that would appropriately be the subject of a district court action.

Both Samsung and the ITC stressed that the ITC action falls within the police or regulatory power exception and therefore is exempt from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. Highlighting certain Third Circuit precedent, Samsung and the ITC argued that the bankruptcy court should apply the pecuniary purpose/public policy test for determining whether the exception applies. Under that test, an action is not exempt from the automatic stay if the government will gain a pecuniary benefit from excluding the goods, or if public policy will not be sufficiently ad-

vanced by the injunction.¹⁵ Additionally, Samsung and the ITC asserted that not only will the government not receive any money from the ITC action, but the fact that the exclusion of infringing goods will protect U.S. industry and jobs proves that the action is advancing public policy.

Samsung and the ITC argued that while a Section 337 complaint is initially filed by a private party, such a procedural feature does not alone resolve the regulatory/police power inquiry. They cited several examples where a private party may incidentally benefit from a government action, and the proceeding itself is still exempt from the automatic stay—i.e., Equal Employment Opportunity Commission, National Labor Relations Board, and Federal Trade Commission actions.

Further, Samsung and the ITC argued that other procedural differences from a private lawsuit also reinforced the conclusion that an ITC action is regulatory in nature, such as the ITC's power to institute an investigation upon its own initiative, the ITC's status as the sole appellant on any appeals before the U.S. Court of Appeals for the Federal Circuit, and the president's power to overturn an ITC exclusion order based on policy concerns.

D. Delaware District Court Decision

On Jan. 28, 2010, while the parties' appeals were pending, the bankruptcy court issued an order regarding the ITC action¹⁶ based on a stipulation between the parties—the net effect of which was termination of the stay in the Chapter 15 case on April 30, 2010 and termination of the stay in the Chapter 11 case on May 10, 2010, the latter of which was the effective date of the reorganization plan.¹⁷ As a result of the order, Spansion argued that Samsung's and the ITC's appeals were moot.¹⁸ The ITC responded by filing a letter brief requesting a vacatur of the bankruptcy court's order if the appeals were judged moot.¹⁹

The U.S. District Court for the District of Delaware held that the appeals were moot because no case or controversy existed after the effective date of the plan because the automatic stay was no longer in place.²⁰ The court also vacated the bankruptcy court's prior rulings on this issue so as to preserve the parties' rights in future litigation.²¹

¹⁵ *United States v. Nicolet*, 857 F.2d 202 (3d Cir. 1988).

¹⁶ *Samsung Electronics Co. v. Ad Hoc Consortium of Floating Rate Noteholders*, No. 09-0836 (RBK), 2010 U.S. Dist. LEXIS 64499 (D. Del. June 29, 2010).

¹⁷ *Id.* at **5-6.

¹⁸ *Id.* at *6.

¹⁹ *Id.* Meanwhile, as in *Qimonda*, it appears the ITC proceeded with the investigation at issue, after initially instituting a limited stay. See *Certain Flash Memory and Products Containing Same*, Inv. No. 337-TA-685 (Order No. 10, March 17, 2010), http://www.itc337update.com/uploads/file/PDF_031710-1.pdf (retrieved November 23, 2010).

²⁰ *Id.* at **7-8.

²¹ *Id.* at **8-9. Additionally, the vacatur effectually negates the bankruptcy court's decision, which could have otherwise been used as harmful precedent against the ITC and complainants seeking to continue their cases and investigations during a bankruptcy.

¹⁴ No. 09-14766-RGM, 2009 WL 2210771 (Bankr. E.D. Va. July 16, 2009), *rev'd*, *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).

VI. Application of the Automatic Stay to Cases Seeking Injunctive Relief

As noted above, the U.S. District Court for the District of Delaware did not reach the merits of Spansion's argument that injunctive relief in the form of an ITC exclusion order does not fall within Section 362(a)(3) of the Bankruptcy Code, which applies to actions seeking "control" over a debtor's property. Several courts determined, however, that IP owners seeking injunctive relief from a debtor should be able to pursue their claims in a district court.

In *Larami Ltd. v. Yes! Entertainment Corp.*,²² the U.S. District Court for the District of New Jersey declined to apply an automatic stay as requested by debtor Yes! Entertainment Corp. against plaintiff Larami's patent infringement action, which sought injunctive relief. The court held that because Larami did not seek to control any of Yes's inventory or equipment, and Yes remained in possession of its existing inventory with the opportunity to modify such equipment in order to avoid future infringement, Section 362(a)(3) did not prevent the court from entertaining Lamari's patent suit. The court noted that, "[a]t its core, plaintiff's suit is an attempt to prevent allegedly unlawful conduct, not an attempt to directly exercise control over the property of the bankruptcy estate."²³ The court further concluded that, "[i]f [Section 362(a)(3)] were read to prevent the injunctive relief sought here, bankrupt businesses which operated post-petition could violate patent rights with impunity."²⁴

The U.S. District Court for the Southern District of Ohio recently reached a similar conclusion in *Dominic's Restaurant of Dayton Inc. v. Mantia*.²⁵ There, the debtor was accused of infringing the trademark of plaintiff Dominic's Restaurant of Dayton Inc. and, after filing for bankruptcy, attempted to stay Dominic's infringement action. In declining to apply an automatic stay, the court noted that application of the automatic stay would permit the debtor to continue to commit the tort of trademark infringement—an activity not protected by the Bankruptcy Code.²⁶ The court further noted that while an assessment of monetary damages against the debtor for its continuing tort may have been prevented by the automatic stay, "injunctive relief regarding the use of the property in the commission of a tort" is not prevented by Section 362(a)(3) of the Bankruptcy Code.²⁷

Finally, in *Amplifier Research Corp. v. Hart*,²⁸ the U.S. District Court for the Eastern District of Pennsylvania held that debtor Amplifier's tort suit against a rival company, EMCO, was not subject to the automatic stay. Amplifier sought to enjoin further publication of an allegedly defamatory report by EMCO. EMCO argued that injunctive relief would fall within Section 362(a)(3) because prohibiting publication and circulation was tantamount to exercising control over the estate property. The court disagreed and instead sought to clarify the meaning of "control" under Section 362(a)(3)²⁹, noting that "[w]hat Amplifier seeks to 'control' . . . is the commission of torts. It does not seek to own EMCO's report, determine how EMCO uses its report internally, share in the proceeds of the report, use the report itself, or prevent any legal use of the report. It just wants EMCO to stop its tortious acts." The court also added that if it were to read Amplifier's request for injunctive relief as an attempt to control EMCO's property it would produce a "bizarre result"³⁰ and "effectively permit a bankrupt company which stays in business post-petition to commit torts with impunity, a privilege not afforded to non-bankrupts."³¹

In opposition to the enforcement of the automatic stay, these decisions suggest that IP owners threatened with an "automatic" stay of an ITC investigation instituted *after* the filing of a bankruptcy petition can argue that the "control" provision of Section 362(a)(3) does not apply, and that the regulatory power exception under Section 362(b)(4) does apply.

VII. Practice Tips

No appellate court has addressed the issue of whether the "regulatory power" exception to the "automatic" stay provisions of the Bankruptcy Code applies to ITC investigations, or whether the exclusion orders sought in such investigations constitute "control" under those provisions. The Delaware district court has considered only the first of these issues.

In view of the arguments made by the parties, and the decisions of district courts addressing similar issues, it seems that IP plaintiffs have strategic options to continue to seek injunctive relief, in the form of an ITC exclusion order, even if an infringer threatens or filed for bankruptcy protection.³²

²² 244 B.R. 56 (D. N.J. Feb. 3, 2000).

²³ *Id.* at 59.

²⁴ *Id.* at 60.

²⁵ 2010 U.S. Dist. LEXIS 39636 (S.D. Ohio Mar. 25, 2010).

²⁶ *Id.* at * 6.

²⁷ *Id.*

²⁸ 114 B.R. 693 (E.D. Pa 1992).

²⁹ *Id.* at 694-95.

³⁰ *Id.* at 695.

³¹ *Id.*

³² In any event, IP plaintiffs should always retain competent bankruptcy and restructuring counsel familiar with these issues.

