IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
Norfolk Division

MERCEXCHANGE, L.L.C., Plaintiff, v. eBAY INC. AND HALF.COM, INC., Defendants.	Case No. 2:01-CV-736

DEFENDANTS EBAY INC. AND HALF.COM, INC.'S OPPOSITION TO MERCEXCHANGE'S RENEWED REQUEST FOR A PERMANENT INJUNCTION

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I. INTRODUCTION

The Court correctly denied MercExchange's request for a permanent injunction in 2003, and the Court should similarly deny MercExchange's renewed request:[1]

- *First*, the Court considered all of the evidence in the record and denied MercExchange's original request for an injunction under the traditional four-factor test. The Supreme Court only questioned this Court's decision to the extent that it may have adopted a categorical rule against non-practicing patentees. The Court did not adopt any such rule, and it should clarify its order, confirm its findings, and deny MercExchange's request.
- *Second*, MercExchange failed to demonstrate any irreparable harm at trial, or show an inadequate legal remedy. MercExchange now seeks to backfill the record with inadmissible hearsay declarations, claiming that neither it nor its licensees can compete with eBay in the so-called "auction market."[2] U.S. Patent 5,845,265 ("the '265 patent") ***does not cover auctions***, and relates to fixed-price systems. eBay achieved its success independent of the '265 patent, as the Court found, and its market presence has not impeded others. Neither MercExchange nor its licensees attempted to build the '265 system, and there is no evidence that MercExchange or any licensee practices the '265 claims. Any harm is purely economic and can be ***adequately compensated by money***.
- *Third*, MercExchange largely rehashes the same arguments about potential lost licensing opportunities and other alleged harms, which were raised on appeal, and ***rejected by the Supreme Court unanimously***. MercExchange's inability to expand existing relationships or develop new ones has nothing to do with eBay and, instead, is due to the Patent Office's repeated ***rejections*** of the ***'265 claims as unpatentable***. The record does not warrant an injunction, and MercExchange cannot carry its burden.

Accordingly, MercExchange's renewed request for an injunction should be denied.

II. BACKGROUND

A. Two months after eBay's launch in September 1995, MercExchange filed the patent application that led to the issuance of the '265 patent.

Over the Labor Day weekend in September 1995, eBay's founder, Pierre Omidyar, wrote the original software for eBay's website and launched its operations later that month. eBay's core operations and processes remain largely unchanged today.

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[1] On August 28, 2006, eBay moved to stay all proceedings in light of the Patent Office's ongoing reexamination of MercExchange's patents, all of which currently stand rejected as unpatentable. While a stay of all proceedings is appropriate, the Court may in its discretion deny MercExchange's request for injunction here, and subsequently stay all remaining proceedings.

[2] MercExchange's attempt to reopen the record is improper. eBay has filed concurrently herewith a separate motion to strike MercExchange's new "evidence" and declarations.

In November 1995—***two months after*** eBay was up, running, and in public use—MercExchange's founder, Thomas Woolston, filed the patent application that issued as the '265 patent while he was working as a patent attorney for a law firm in Washington, D.C.[3] Mr. Woolston's idea was to computerize traditional consignment store operations by establishing a network of trusted "consignment nodes," through which sellers would bring their goods to a trusted ("vetted" and "franchised") consignment node operator. Declaration of Robert W. McFarland ("McFarland Decl."), Ex. 1 at Abstract, 1:34-36, 2:20-24, 2:27-30, 2:46-57; Dkt. 331 at 1-2; McFarland Decl., Ex. 5 at 259. The consignment node operator would inspect the good to ensure that it was bona fide, take possession of the good, obtain the right to transfer ownership through a bailment or consignment contract, and post a description of the good on the consignment network. McFarland Decl., Ex. 1 at 3:57-66; Dkt. 237 at 8-11. Only trusted consignment node operators could post goods on the network. McFarland Decl., Ex.1 at 2:7-10, 2:46-57; Dkt. 331 at 1-2; McFarland Decl., Ex. 6 at 262-263. Thus, a buyer could avoid the "leap of faith" necessary to deal directly with an anonymous or unfamiliar seller because, according to the '265 patent, a customer would know a good would be in the legal and physical possession of trusted a consignment node operator who had inspected and vouched for its quality and who would transfer legal title upon payment. Dkt. 237 at 3; Dkt. 331 at 1-2; McFarland Decl., Ex. 6 at 262; McFarland Decl., Ex. 7 at 3637-3638, McFarland Decl., Ex. 1 at 4:9-12, 12:20-26, 17:1-12, 18:27-37; Dkt. 237 at 4-6; Dkt. 558 at 3-5; McFarland Decl., Ex. 6 at 262-263; McFarland Decl., Ex. 8 at 3636-3637.

The claims of the '265 patent recite apparatuses for implementing this concept to conduct ***sales*** of goods ***at a fixed-price***. *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1325 (Fed. Cir. 2005). ***None*** of its claims cover or implicate ***auction-format*** sales. Dkt. 349 at 2-7.

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[3] Mr. Woolston's November 1995 application added a significant amount of new material to an earlier application he filed in April 1995. McFarland Decl., Ex. 2 (showing underscored additions to original application); McFarland Decl., Ex. 3 at 469:15-17. MercExchange was, however, forced to abandon the April 1995 application last year, after failing to persuade the Patent Office that it described a patentable invention. McFarland Decl., Ex. 4.

B. As eBay succeeded, MercExchange made no effort to build the '265 system.

eBay adopted a person-to-person system—the polar opposite of the '265 trusted intermediary model—on the revolutionary assumption that even anonymous buyers and sellers are basically good and will not cheat one another. Dkt. 219 at 3-4; Dkt. 237 at 3-4; McFarland Decl., Ex. 9 at Tr. 261-262; McFarland Decl., Ex. 10 at 1411-1416; McFarland Decl., Ex. 11 at 1415-1416; McFarland Decl., Ex. 12 at 1455-1461; McFarland Decl., Ex. 13 (Whitman Depo Tr. 114-115). In eBay's model, buyers and sellers deal directly with one another and consummate transactions themselves. Dkt. 219 at 3; Dkt. 488 at 147-148; McFarland Decl., Ex. 14 at 264-265; McFarland Decl., Ex. 15 at 1406-1407; Dkt. 485 at 254-255. Unlike the '265 consignment concept, eBay does not and cannot take responsibility for consummating transactions between buyers and sellers because it does not take possession of the goods, inspect them, confirm they are bona fide or obtain any right to transfer legal ownership. Dkt. 219 at 4; Dkt. 237 at 3-4; Dkt. 237 at 7-8; Dkt. 477 at 224-225; Dkt. 477 at 230-231; McFarland Decl., Ex. 16 (Omidyar Depo. Tr. 254-255); McFarland Decl., Exs. 17-19; McFarland Decl., Ex. 20 at 264-267; McFarland Decl., Ex. 21 at 280; McFarland Decl., Ex. 22 at 1036-1038; McFarland Decl., Ex. 23 at 1374; McFarland Decl., Ex. 24 at 1404.

From 1995 to 1999, eBay became one of the Internet's great success stories, amassing more than a hundred million registered members around the world. McFarland Decl., Ex. 25 at 1355-1356; McFarland Decl., Ex. 26 at 537-538; Dkt. 581 at 11. eBay's "success did not arise from the use of anything contained in the plaintiff's patents," as the Court found. Dkt. 598 at 38. During this same period, MercExchange continued to prosecute the '265 patent, but never attempted to build the system described in the patent.[4] As the Court observed, the '265 patent contained no software or guidance for implementing the high level concepts it disclosed, and Mr.

[4] Mr. Woolston tried unsuccessfully to cash in on other purported inventions, claiming that he invented PriceLine's name-your-price travel service—popularized by William Shatner—based on the same '265 patent disclosure asserted against eBay here. *See* Dkt. 109 at 5; Exs. 7-9 to McFarland Decl. in Support of Dkt. 109. While Mr. Woolston attempted to sell this and other concepts to Budget Rental Cars, Microsoft and video game companies, each declined.

Woolston testified he had not attempted to write any such software. McFarland Decl., Ex. 27 at 488:10-14; McFarland Decl., Ex. 28 at 537:14-17; McFarland Decl., Ex. 29 at 538:13-19; McFarland Decl., Ex. 30 at 539:3-7. Instead, Mr. Woolston shopped a business plan to investors for "Fleanet," ***which he testified was <u>not</u> intended to commercialize the '265 patent.*** McFarland Decl., Ex. 31 at 654:16-19; McFarland Decl., Ex. 32 at 356:25-357:5 ("Q. Was the Fleanet business plan designed to be a complete commercialization of your invention? A. No. Q. What is the relationship between the Fleanet business plan and the claims in your invention, if any? A. Very little."). Mr. Woolston approached venture funds, Internet startups, antique and art dealers, web developers, and George Mason University—but found no takers. None of the potential investors ever mentioned eBay when they passed on the opportunity to invest in Fleanet, and Mr. Woolston himself had not even heard of eBay at the time, as he testified at trial. McFarland Decl., Ex. 33 at Tr. 503:9-513:20; McFarland Decl., Ex. 34 at 534:20-538:6; Dkt. 109, Exs. 1-4.

C. In 1999, MercExchange and Aden Enterprises—an insolvent holding company—combined with the secret goal of suing eBay.

By 1999, Mr. Woolston and MercExchange had still made no effort to implement the '265 system. Instead, MercExchange found a partner, Aden Enterprises—an Omaha-based holding company, with significant financial problems.[5] MercExchange accepted these problems and agreed that the two companies would be co-owned and managed. The companies' "primary purpose" was ***not*** to commercialize the '265 patent or anything else, but rather to share in any recovery in a lawsuit ***against eBay***. McFarland Decl., Ex. 38. A "Patent Enforcement Agreement" memorialized their plans to share the proceeds from a suit against eBay with not only each other, but also with MercExchange's current counsel. McFarland Decl., Ex. 39.

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[5] MercExchange contends Aden was "embarking on a major industry initiative to build and deploy Internet Markets and Auctions," Merc. Br. at 3, but the record tells a different story. Aden: was "not in compliance" with S.E.C. regulations, McFarland Decl., Ex. 35; had never operated at a profit, *id.*; was saddled with "significant debt and litigation," *id.*; operated at a 300% loss over revenue, McFarland Decl., Ex. 36 (Luther Depo. Tr. 30-34); was subject to "several" tax liens, *id.* at 173-174; and "did not have the financial resources available to exercise its rights and meet its obligations" in the agreement MercExchange now cites. McFarland Decl., Ex. 37 at 9-10.

Resolved to sue eBay, MercExchange and Aden formed two subsidiaries, Leftbid and Navlet, that were also co-owned by MercExchange and managed in varying capacities by Mr. Woolston. Each company entered into ***self-dealing*** agreements to license MercExchange's patents, and even Mr. Woolston testified he had trouble figuring out which corporate hat he was wearing during the negotiations, prompting MercExchange to concede that these were ***not*** "arm's length" transactions.[6] *Compare* McFarland Decl., Ex. 40 at 557:25-558:6; McFarland Decl., Ex. 41 at 559:18-21; McFarland Decl., Ex. 42 at 561:12-562:7; McFarland Decl., Ex. 43 at 563:16-24 *with* Merc. Br. at 3-4, 18-19.

D. The MercExchange-Aden family never attempted to build the '265 system.

Although the Aden-family "licenses" required a "nexus" between any developed products and MercExchange's patents, Mr. Woolston was the one charged with product development and ***never attempted*** to build the '265 system—focusing instead on ***auction-related*** software for LeftBid that had ***nothing to do*** with the '265 fixed-price approach. McFarland Decl., Ex. 44 (Petsick Depo. Tr. 77:2-16); McFarland Decl., Ex. 45 (Borghi Depo. Tr. 176:15-177:13), McFarland Decl., Ex. 46 (McEachern Depo. Tr. 162:12-17). After Mr. Woolston could not produce a viable system, Leftbid was forced to purchase an off-the-shelf product that worked. The Aden-MercExchange marriage began to deteriorate in 2000. On May 4, 2000, Aden filed suit against MercExchange to terminate their collaboration, and MercExchange responded with a lawsuit of its own against Aden on May 8, 2000. McFarland Decl., Ex. 47. The parties settled their actions, terminated all agreements, and went their separate ways. McFarland Decl., Ex. 48.

E. MercExchange's decision not to build the '265 patent had nothing to do with eBay, and eBay's success had nothing to do with the '265 patent.

MercExchange's failure to commercialize the '265 patent was a result of MercExchange's repeated decisions to pursue *other* activities. Mr. Woolston testified that his

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[6] At the time, Mr. Woolston served as MercExchange's managing director, Aden's and Leftbid's Chief Technology Officer, and Navlet's President, with Aden holding an interest in MercExchange and MercExchange holding an interest in Aden, Leftbid and Navlet.

failure to generate interest in his Fleanet business plan was not due to eBay. McFarland Decl., Ex. 26 at 537-538. MercExchange also represented to the Court that ***more than one thousand*** other companies were able to implement online marketplaces, despite eBay's presence. Dkt. 81 at 25-26; Dkt. 84 at ¶¶ 72-73, Exs. 17-19. In addition, MercExchange's own experts conceded that eBay was a huge success before even MercExchange contends it began infringing the '265 patent, confirming the Court's correct conclusion that eBay's "success ***did not arise*** from the use of ***anything*** contained in [MercExchange]'s patents." Dkt. 598 at 38 (emphasis added).

F. MercExchange approached eBay, under the guise of offering assistance, and carefully avoided any suggestion of eBay's alleged infringement—even though MercExchange was already secretly planning to sue eBay.

While MercExchange erroneously contends that "eBay approached MercExchange to discuss eBay's interest in buying MercExchange's patent[s]," it was MercExchange that initiated a meeting with eBay and for entirely different reasons. In 2000, eBay was involved in a dispute with Bidder's Edge, and MercExchange's patent attorney and co-owner, John Phillips, contacted a former classmate working at eBay to offer the now invalid '176 patent for use in that dispute. The parties' interaction was primarily directed to organizing a meeting and for eBay's review of MercExchange's prosecution files. McFarland Decl., Exs. 49-56. eBay did show interest in acquiring MercExchange's patent portfolio, but ***subject to*** "develop[ing] a process for moving forward including eBay's ***due diligence re this portfolio*** of patents." McFarland Decl., Ex. 57 (emphasis added). MercExchange never permitted eBay to conduct such diligence and blocked eBay's efforts to review the patents' prosecution files, and the talks broke down.[7] McFarland Decl., Ex. 56. During the talks, MercExchange carefully avoided any suggestion that eBay infringed, even though it secretly planned to sue eBay. McFarland Decl., Ex. 58 at 1088:23-1089:18; McFarland Decl., Ex. 59 at 597:21-24. eBay had no notice of the alleged infringement—until MercExchange filed this lawsuit.

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[7] eBay ultimately obtained a preliminary injunction against Bidder's Edge without the '176 patent. *eBay Inc. v. Bidder's Edge, Inc.*, 100 F. Supp. 2d 1058 (N.D. Cal. 2000).

G. eBay used a payment system, as the Court found, long before MercExchange approached it.

While MercExchange points to eBay's 2000 acquisition of PayPal—an online payment system—as the key event that culminated in the alleged infringement, eBay had been using payment systems long before then. In May 1999, eBay acquired Billpoint—another online payment system that had become popular with eBay users. Dkt. 486, at 62-63. Later in 1999, eBay also initiated negotiations to acquire Half.com, a fixed-price, person-to-person market with a payment system, which had been online for months. Dkt. 486 at 65:13-17; Dkt. 478 at 247:9-13, 353:15-22; Dkt. 484 at 46:12-14. While the Court correctly found that "eBay was ***using payment processors long before*** it received notice of the '265 patent," Dkt. 598 at 38 (emphasis added), MercExchange erroneously maintains that eBay copied the '265 system after the parties met, even though eBay used payment systems before the meeting.[8] The Court, however, already found that that there was no copying because "the ***patents offer no business or engineering guidance which the defendants could copy***." Dkt. 598 at 38 (emphasis added).

H. MercExchange settled its lawsuit against GoTo.com and granted GoTo.com a non-exclusive license to its entire patent portfolio for $4 million.

Meanwhile, MercExchange sued GoTo.com for infringement of the '176 patent on the eve of GoTo's merger with another company. MercExchange settled the case for a $4 million reserve that GoTo set aside as a contingency for the litigation and considered a sunk cost necessary to consummate the merger.[9] As part of the settlement, MercExchange granted GoTo a full release and ***a fully paid up, non-exclusive license to all of MercExchange's patents.*** McFarland Decl., Ex. 60, McFarland Decl., Ex. 61.

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[8] MercExchange's contention that eBay did not infringe until it acquired PayPal is also undermined by its proposed injunction, which seeks to enjoin Billpoint. *See* Prop. Ord. at 1.

[9] GoTo moved for summary judgment of invalidity using the same prior art that the Federal Circuit later found invalidated the '176 patent in this case, but the case settled.

I. Before this lawsuit, MercExchange valued its entire company at $50,000 to the Internal Revenue Service and then at $2-$3.5 million to its shareholders.

Prior to this lawsuit, MercExchange's official position on the value of its company was much different than the one it took before the Court. In October 2000, MercExchange valued its entire company, ***including all patents and patent applications***, at $50,000 for tax reporting purposes. McFarland Decl., Ex. 62 at 1100:18-1101:11. That same year, Messrs. Woolston and Phillips informed its minority shareholders that MercExchange was worth between $2 and $3.5 million, McFarland Decl., Ex. 63 at 565:19-566:2; McFarland Decl., Ex. 64—a value in line with MercExchange's offer to sell 10% of its stock to Aden in 1999 for $250,000.

J. After MercExchange carefully avoided accusing eBay of infringement, MercExchange filed the present action.

On September 26, 2001, MercExchange filed this suit against eBay alleging infringement of the '265, '176 and '051 patents.[10] Disregarding its prior sworn and fiduciary valuations, MercExchange sought over $100 million in damages for approximately two years of infringement. MercExchange engaged in numerous improper tactics in an attempt to cash in on eBay's success by, *inter alia* advancing arguments the Court noted were "completely inappropriate," "completely disingenuous," Dkt. 274 at 7-8, and "made in bad faith," Dkt. 349 at 5-7. MercExchange also threatened numerous third-party witnesses, and attempted to disbar a former Patent Office Commissioner—a tactic the Court found was done by MercExchange "purely for strategic purposes."[11] Dkt. 240 at 11. The Court noted MercExchange did not come to the Court with "perfectly clean hands." Dkt. 598 at 39.

In addition, MercExchange survived summary judgment on all its claims by completely reversing course on the most important issue litigated in the case. The parties exhaustively argued whether MercExchange's patent claims were limited to the '265 patent's "trusted

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[10] The Federal Circuit invalidated the '176 patent and found there was a triable issue on the validity of the '051 patent, which includes an inadequate written description and was obtained through inequitable conduct before the Patent Office. *MercExchange*, 401 F.3d at 1324.

[11] MercExchange's improper tactics are detailed in the parties' briefing that led to the Court's denial of MercExchange's request for enhanced damages. Dkt. 581 at 12-17.

intermediary" consignment-concept or could extend to person-to-person systems, such as eBay, during a two-day *Markman* hearing. There was no dispute as to what these terms meant or that eBay was a person-to-person system. MercExchange openly acknowledged this fact on the record: "***a person-to-person auction which is really the model that eBay has***"; "eBay really won the day because ***eBay had adopted the person-to-person model***"; and "***that kind of person-to-person individual network . . . was so critical to the success of eBay.***" Dkt. 179 at 43-44. The only dispute was whether the claims could cover a person-to-person system.

In a ruling that could have ended the litigation, the Court resolved that question in eBay's favor, holding that "the patent teaches away from person-to-person auctions, favoring a system with a trusted intermediary . . . . Therefore, when the claims are read in light of the specification, an auction must occur on a trusted network or with a trusted intermediary." Dkt. 207 at 12. The Court's ruling explained the necessary aspects that defined the otherwise vague term "trusted network": "Everything disclosed in the '051 patent revolved around a trusted intermediary to present a good to market, add value to the description of the item, transfer ownership of the item, and extract a commission based on the sales price." *Id.* Facing defeat, MercExchange launched into "a diatribe regarding the court's *Markman* Opinion" and complained that MercExchange had no clue what a trusted network was and faced "a fundamental due process problem. . . . [T]he Court has never provided a definition for 'trusted intermediary' or ''trusted network,' and MercExchange is left without any substantial basis upon which to establish these undefined elements." Dkt. 271 at 15-18, Dkt. 282 at 4, Dkt. 558 at 6, Dkt. 581 at 13-14. After eBay noted that the Court provided the necessary aspects of a trusted network in its *Markman* opinion, the Court dismissed MercExchange's arguments as "completely disingenuous." Dkt. 274 at 8.

MercExchange nevertheless seized upon the "fundamental due process problem" at trial and embraced the ambiguity of the term "trusted network" in the abstract. *Compare* Dkt. 207 at 28-30 *with* McFarland Decl., Ex. 65 at 1610. Contradicting the Court's *Markman* ruling, MercExchange argued to the jury that eBay's person-to-person system ***was*** a "trusted network" as described and claimed in the '265 patent. *Compare* Dkt. 207 at 10-12 *with* McFarland Decl.,

Ex. 66 at 3707-3708. MercExchange blocked eBay's proposed jury instruction that included the Court's complete construction *verbatim*, and the jury was left to construe the term on its own—something MercExchange's experts could not do.[12]

K. MercExchange convinced AutoTrader to take a license, without disclosing that the '051 patent was invalid, in an attempt to bolster its damages theory.

In December 2002, AutoTrader took a license to all of MercExchange's patents and applications for the automobile-sales field of use. McFarland Decl., Ex. 69 at 4. While MercExchange contends that the license "permits AutoTrader to make exclusive use of the '265 patent within the field of automobile sales," (Merc. Br. at 7), the license is "non-exclusive" by its own terms, and AutoTrader does not use or practice the '265 patent. *Id.* The license is limited to AutoTrader's "auction-related activities" and only requires royalties if MercExchange "obtains a judicial injunction that prohibits eBay, Inc. from operating within the Field of Use"—a ***condition the '265 patent cannot satisfy*** because it does not prohibit eBay's auction sales in that field. The license also permits AutoTrader to ***opt out*** whenever it desires.[13] McFarland Decl., Ex. 69 at 4.

L. MercExchange fails to inform the Court that it licensed or sold significant assets to a hedge fund, Altitude Capital.

MercExchange failed to disclose that a hedge fund, Altitude Capital, invested "substantial millions" in MercExchange, while the case was on appeal.[14] McFarland Decl., Ex. 70 (Altitude Capital "recently made a sizable bet on MercExchange, investing 'substantial millions' to recapitalize the company and help it build a sustainable revenue model."). Altitude Capital's

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[12] *See* McFarland Decl., Ex. 67 at 1681 ("[T]hat question is very difficult to answer because trust is not an absolute. Trust is a goal. ... So if you get the feeling you are secure, you can trust it, then it is a question of trust."); McFarland Decl., Ex. 68 at 1300-1301 ("I don't think that the issue is cut and dry. ... I don't believe there is a single instantiation, but I believe that trust has typically some of these elements that I have talked about").

[13] At the time of the license, eBay and MercExchange disputed whether "gross merchandise sales" could be used as a basis for MercExchange's damages theory, rather than the actual revenue eBay receives from sales on its site. The AutoTrader license coincidentally adopted gross merchandise sales, giving MercExchange "evidence" to bolster its damages theory, but other terms show that it is illusory and allow AutoTrader to opt out at any time.

[14] Local Rule 7.1 requires that MercExchange disclose Altitude Capital's financial interest.