

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

OFFICE DEPOT INC.,

Defendant.

**REDACTED PUBLIC VERSION
ISSUED 3/31/16**

C.A. No. 13-239

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

J.C. PENNEY COMPANY, INC.,

Defendant.

C.A. No. 13-287

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

QVC INC.,

Defendant.

C.A. No. 13-288

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

SEARS HOLDINGS COMPANY,

Defendant.

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C.A. No. 13-289

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

LIMITED BRANDS, INC.,

Defendant.

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C.A. No. 13-326

PRINCETON DIGITAL IMAGE
CORPORATION,

Plaintiff,

v.

GAP INC.,

Defendant.

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C.A. No. 13-330

Sean T. O'Kelly, George Pazuniak, Daniel P. Murray, O'KELLY, ERNST, & BIELLI, LLC,
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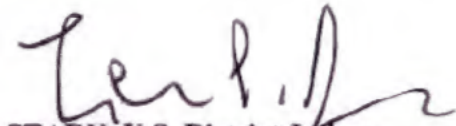
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Counsel for Intervenor Adobe Systems Incorporated.

MEMORANDUM OPINION

March 28, 2016
Wilmington, Delaware


STARK, U.S. District Judge:

Several motions are pending before the Court in these multiple related patent cases:

(1) Intervenor Adobe System Incorporated's ("Adobe")¹ Rule 12(b)(6) Motion to Dismiss Plaintiff Princeton Digital Image Corporation's ("PDIC" or "Princeton") Counterclaim (C.A. No. 13-404 D.I. 52)² ("Adobe's Motion to Dismiss"),³ (2) Adobe's Renewed Motion for Sanctions (D.I. 65) ("Adobe's Motion for Sanctions"),⁴ (3) PDIC's Motion to Dismiss Claims in Intervention of Adobe (D.I. 66) ("PDIC's Motion to Dismiss"),⁵ and (4) Adobe's Cross Motion for Judgment on the Pleadings (D.I. 75) ("Adobe's Motion for Judgment on the Pleadings").⁶

I. BACKGROUND

██████████ PDIC and Adobe entered into an agreement ("Adobe License") whereby PDIC duly licensed its U.S. Patent No. 4,813,056 ("056 patent") to Adobe and Adobe's customers. (See generally D.I. 12 Ex. 2) The Adobe License included a covenant by PDIC not

¹The Court previously granted Adobe's Omnibus Motion to Intervene as a matter of right in all of the above-captioned cases pursuant to Rule 24(a)(2) and permissively pursuant to Rule 24(b)(1)(B). (See, e.g., C.A. No. 13-404 D.I. 44)

²All docket citations hereinafter are to C.A. No. 13-404 unless otherwise specified.

³Adobe filed identical motions seeking to dismiss PDIC's counterclaim, and the parties submitted identical briefing with respect to these motions, in all of the above-captioned cases *except* C.A. No. 13-408.

⁴Identical motions and briefing were submitted by the parties in all of the above-captioned cases with respect to this motion.

⁵Identical motions and briefing were submitted by the parties in all of the above-captioned cases with respect to this motion.

⁶Identical motions and briefing were submitted by the parties in all of the above-captioned cases with respect to this motion.

to sue Adobe's customers for infringement of the '056 patent by their use of Adobe's products. (*See id.*)

In 2013, PDIC filed the above-captioned lawsuits against Office Depot Inc., J.C. Penney Company, Inc., QVC Inc., Sears Holding Company, Limited Brands, Inc., Gap Inc., Williams-Sonoma Inc., Costco Wholesale Corp., Nordstrom.com LLC, Nordstrom.com Inc., and Nordstrom Inc. (collectively, "Defendants").⁷ As each of these Defendants are Adobe customers, on November 26, 2014 Adobe moved to intervene in these lawsuits. (D.I. 10) Adobe argued that it had a right to intervene due to its customers' requests for indemnity under the Adobe License and because of PDIC's refusal to "engage in further discussions" with Adobe, which would be necessary to "clarify and resolve" the lawsuits. (*See* D.I. 11 at 9, 11) The Court granted Adobe's motion to intervene on May 5, 2015. (*See* D.I. 44)

On May 8, 2015, Adobe filed a complaint in intervention (D.I. 46), alleging (1) breach of contract based on PDIC's infringement suits against Defendants, which Adobe argued violated the covenant not to sue Adobe's customers contained in the Adobe License, and (2) patent misuse by PDIC for its assertion of the '056 patent, which Adobe characterized as an attempt to "collect double royalties" from Adobe's customers after already receiving [REDACTED] from Adobe under the Adobe License. (*See* D.I. 46 at 8-9) On May 29, 2015, PDIC filed an answer to Adobe's complaint in intervention and counterclaim in all of the above-captioned actions, with the exception of C.A. No. 13-408.⁸ (D.I. 50) PDIC's counterclaim alleged breach of the implied

⁷The nine suits which the Court is addressing here are a subset of the 51 related suits PDIC filed in this District in 2012 and 2013, all asserting infringement of the '056 patent.

⁸PDIC did not respond to Adobe's complaint in C.A. No. 13-408. Consequently, on March 8, 2016, the Clerk of Court entered default against PDIC in that action. (*See* C.A. No. 13-

covenant of good faith and fair dealing based on, among other things, Adobe's failure to cooperate with PDIC in resolving questions about whether Defendants were licensed under the Adobe License. (*See id.* at 9-12)

Meanwhile, on January 14, 2015, while Adobe's motion to intervene was pending before the Court, Adobe filed a motion for sanctions against PDIC. (D.I. 25) The Court held a hearing on May 5, 2015, at which it heard argument on the sanctions motion (as well as on Adobe's motion to intervene). (*See* D.I. 51 ("2015 Tr.")) At the conclusion of the hearing, the Court denied Adobe's motion for sanctions but without prejudice to Adobe's opportunity to renew its request for sanctions after filing its complaint in intervention. (*See* D.I. 44; *see also* D.I. 51 at 81-86) The focus of Adobe's original motion for sanctions was whether PDIC's counsel had conducted an adequate pre-suit investigation in compliance with their obligations under Federal Rule of Civil Procedure 11. On this issue, the Court stated at the May 2015 hearing:

.... I am not imposing sanctions at this point, but that denial is very much without prejudice.

What is clear to me is that the conduct of plaintiff and plaintiff's counsel is at least close to the line that Rule 11 requires the Court to draw. What I can't tell today and what I think under the circumstances I do not need to spend the time trying to decide [today] is which side of that line plaintiff and plaintiff's counsel fall [on].

They may well have conducted a just barely adequate investigation given all the facts and circumstances prior to suit. They may have just enough to in good faith have continued with these cases up to at least today. But they very well may not have.

408 D.I. 88) PDIC filed a motion to set aside default on March 11 (C.A. No. 13-408 D.I. 89), which remains pending.

(2015 Tr. at 84)

On May 8, 2015, Adobe filed its complaint in intervention against PDIC. (*See* D.I. 46) Thereafter, between May 19, 2015 (*see, e.g.*, C.A. No. 13-408 D.I. 51) and July 30, 2015 (*see, e.g.*, D.I. 13-331 D.I. 62), PDIC dismissed its claims against each of the Defendants in the above-captioned suits. (*See, e.g.*, D.I. 62) (July 21, 2015 stipulation of dismissal between PDIC and Costco)

On August 21, 2015, Adobe filed a renewed motion for sanctions. (D.I. 65) Adobe's renewed sanctions motion again contends that PDIC failed to conduct an adequate pre-suit investigation before suing Defendants. (*See* D.I. 67 at 10-13) It further alleges that PDIC maintained baseless litigation positions "after receiving uncontroverted evidence," particularly relating to the Adobe License, that should have compelled dismissal. (*See id.* at 10) The renewed motion also contends that PDIC engaged in "persistent frivolous, wanton, and vexatious litigation conduct." (*Id.* at 18) Adobe seeks relief under Rule 11 as well as attorney fees under 35 U.S.C. § 285 (for an "exceptional" patent case), 28 U.S.C. § 1927 (for unreasonable or vexatious multiplication of proceedings), and sanctions pursuant to the Court's inherent authority. (*See id.*)

Also on August 21, 2015, PDIC filed a motion to dismiss the patent misuse and breach of contract claims in Adobe's complaint in intervention. (D.I. 66) With respect to patent misuse, PDIC argues that there is no case or controversy, and further that Adobe fails to state a claim on which relief may be granted. (*See* D.I. 68 at 8, 10) With respect to Adobe's breach of contract claim, PDIC alleges that the Court lacks jurisdiction. (*See id.* at 16-20)

In responding to PDIC's motions on September 9, 2015, Adobe cross-moved for

judgment on the pleadings on its breach of contract claim. (See D.I. 75, 77) Abode contends that PDIC breached its express covenant not to sue Adobe's customers for using products licensed under the Adobe License, adding that PDIC "in bad faith filed, maintained, and vexatiously litigated these baseless cases against Adobe's licensed customers for years." (See D.I. 77 at 1-2)

The parties completed briefing on all pending motions on October 8, 2015. (See generally D.I. 53, 57, 60, 67, 68, 74, 77, 84, 85, 89, 90) The Court heard oral argument on March 8, 2016. (See Transcript ("Tr."))

II. LEGAL STANDARDS

A. Motion to Dismiss for Failure to State a Claim

Evaluating a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) requires the Court to accept as true all material allegations of a complaint. See *Spruill v. Gillis*, 372 F.3d 218, 223 (3d Cir. 2004). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1420 (3d Cir. 1997) (internal quotation marks omitted). Thus, the Court may grant such a motion to dismiss only if, after "accepting all well-pleaded allegations in the complaint as true, and viewing them in the light most favorable to plaintiff, plaintiff is not entitled to relief." *Maio v. Aetna, Inc.*, 221 F.3d 472, 481-82 (3d Cir. 2000) (internal quotation marks omitted).

However, "[t]o survive a motion to dismiss, a civil plaintiff must allege facts that 'raise a right to relief above the speculative level on the assumption that the allegations in the complaint are true (even if doubtful in fact).'" *Victaulic Co. v. Tieman*, 499 F.3d 227, 234 (3d Cir. 2007) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (internal citations and quotation

marks omitted)). A claim is facially plausible “when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). “The complaint must state enough facts to raise a reasonable expectation that discovery will reveal evidence of [each] necessary element” of a plaintiff’s claim. *Wilkerson v. New Media Tech. Charter Sch. Inc.*, 522 F.3d 315, 321 (3d Cir. 2008) (internal quotation marks omitted).

The Court is not obligated to accept as true “bald assertions,” *Morse v. Lower Merion Sch. Dist.*, 132 F.3d 902, 906 (3d Cir. 1997) (internal quotation marks omitted), “unsupported conclusions and unwarranted inferences,” *Schuylkill Energy Res., Inc. v. Pennsylvania Power & Light Co.*, 113 F.3d 405, 417 (3d Cir. 1997), or allegations that are “self-evidently false.” *Nami v. Fauver*, 82 F.3d 63, 69 (3d Cir. 1996).

B. Motion to Dismiss for Lack of Subject Matter Jurisdiction

“Federal Rule of Civil Procedure 12(b)(1) authorizes dismissal of a complaint for lack of jurisdiction over the subject matter, or if the plaintiff lacks standing to bring his claim.”

Samsung Elec. Co., Ltd. v. ON Semiconductor Corp., 541 F. Supp. 2d 645, 648 (D. Del. 2008).

A Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction may present either a facial attack or a factual attack. *See CNA v. United States*, 535 F.3d 132, 139 (3d Cir. 2008); Fed. R. Civ. P. 12(b)(1). A facial attack concerns an alleged pleading deficiency, while a factual attack concerns the failure of a plaintiff’s claim to comport factually with the jurisdictional prerequisites. *See CNA*, 535 F.3d at 139. Where the motion presents a facial challenge to the Court’s jurisdiction, or one based purely on the allegations in the complaint, the Court must accept well-pleaded factual allegations as true and may consider only the complaint and any

documents upon which it is based. See *Petrusha v. Gannon Univ.*, 462 F.3d 294, 302 n.3 (3d Cir. 2006). Where subject matter jurisdiction is challenged based upon the sufficiency of jurisdictional facts, the Court is not required to attach any presumptive truthfulness to the allegations in the complaint and may consider matters outside the pleadings to satisfy itself that it has jurisdiction. See *Animal Sci. Products, Inc. v. China Minmetals Corp.*, 654 F.3d 462, 469 n.9 (3d Cir. 2011), as amended (Oct. 7, 2011). In either case, the plaintiff bears the burden of persuasion. See *Kehr Packages, Inc. v. Fidelcor, Inc.*, 926 F.2d 1406, 1409 (3d Cir. 1991).

C. Motion for Judgment on the Pleadings

Pursuant to Federal Rule of Civil Procedure 12(c), a party may move for judgment on the pleadings “[a]fter pleadings are closed – but early enough not to delay trial.” When evaluating a motion for judgment on the pleadings, the Court must accept all factual allegations in a complaint as true and view them in the light most favorable to the non-moving party. See *Rosenau v. Unifund Corp.*, 539 F.3d 218, 221 (3d Cir. 2008). This is the same standard as applies to a Rule 12(b)(6) motion to dismiss. See *Turbe v. Gov’t of Virgin Islands*, 938 F.2d 427, 428 (3d Cir. 1991); see also *Maio*, 221 F.3d at 482.

A Rule 12(c) motion will not be granted “unless the movant clearly establishes that no material issue of fact remains to be resolved and that he is entitled to judgment as a matter of law.” *Rosenau*, 539 F.3d at 221. “The purpose of judgment on the pleadings is to dispose of claims where the material facts are undisputed and judgment can be entered on the competing pleadings and exhibits thereto, and documents incorporated by reference.” *Venetec Int’l, Inc. v. Nexus Med., LLC*, 541 F. Supp. 2d 612, 617 (D. Del. 2008); see also *Burlington Coat Factory*, 114 F.3d at 1426 (explaining that any documents integral to pleadings may be considered in

connection with Rule 12(c) motion). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Burlington Coat Factory*, 114 F.3d at 1420 (internal quotation marks omitted).

The Court may consider matters of public record as well as authentic documents upon which the complaint is based if attached to the complaint or as an exhibit to the motion. See *Oshiver v. Levin, Fishbein, Sedran & Berman*, 38 F.3d 1380, 1384 n.2 (3d Cir. 1994). The Court may also take judicial notice of the factual record of a prior proceeding. See *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 416 n.3 (3d Cir. 1988). Ultimately, a motion for judgment on the pleadings can be granted "only if no relief could be afforded under any set of facts that could be proved." *Turbe*, 938 F.2d at 428.

D. Motion for Sanctions

1. Rule 11

Federal Rule of Civil Procedure 11 "provides that an attorney who fails to either (1) read the pleading; (2) make a reasonable inquiry into the factual and legal legitimacy of the pleading; or (3) file the pleading only for a proper purpose, shall be sanctioned." *Simmerman v. Corino*, 27 F.3d 58, 62 (3d Cir. 1994). Additionally, "sanctions are proper when, *inter alia*, a party 'insist[s] upon a position after it is no longer tenable . . .'" *Balthazar v. Atl. City Med. Ctr.*, 137 F. App'x 482, 490 (3d Cir. 2005) (citing Advisory Committee's Note to Rule 11). "Absent exceptional circumstances, a law firm must be held jointly responsible for a violation committed by its partner, associate, or employee." Fed. R. Civ. P. 11(c)(1).

2. 28 U.S.C. § 1927

"Any attorney or other person admitted to conduct cases in any court of the United States

or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." 28 U.S.C. § 1927. The Third Circuit has interpreted § 1927 to permit fee awards where "an attorney has (1) multiplied proceedings; (2) in an unreasonable and vexatious manner; (3) thereby increasing the cost of the proceedings; and (4) doing so in bad faith or by intentional misconduct." *In re Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions*, 278 F.3d 175, 188 (3d Cir. 2002). In cases where a party is represented by counsel, § 1927 "is designed to discipline counsel only and does not authorize imposition of sanctions on the attorney's client." *Zuk v. E. Pennsylvania Psychiatric Inst. of the Med. Coll. of Pennsylvania*, 103 F.3d 294, 297 (3d Cir. 1996).

3. Inherent Authority

"[A]n award of fees and costs pursuant to the court's inherent authority to control litigation will usually require a finding of bad faith." *Prudential*, 278 F.3d at 188. The Supreme Court has authorized lower courts to use their "inherent power to police" themselves and "assess attorney's fees when a party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45-46 (1991) (internal quotation marks omitted).

4. 35 U.S.C. § 285

In "exceptional" patent cases, a court may "award reasonable attorney fees to the prevailing party." 35 U.S.C. § 285. The Supreme Court has held that an "exceptional" case is "one that stands out from others with respect to the substantive strength of a party's litigating position (considering both the governing law and the facts of the case) or the unreasonable

manner in which the case was litigated.” *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014). “[A] district court may award fees in the rare case in which a party’s unreasonable conduct – while not necessarily independently sanctionable – is nonetheless so ‘exceptional’ as to justify an award of fees.” *Id.* at 1757. A finding of bad faith is not required to award attorney fees under § 285. *See id.* The burden is on the movant to prove by a preponderance of the evidence that it should receive an award of attorney fees under § 285. *See id.* at 1758. Ultimately, a court must make a discretionary decision based on the totality of circumstances. *See id.* at 1756.

III. DISCUSSION

A. Adobe’s Motion to Dismiss

Adobe moves under Rule 12(b)(6) to dismiss PDIC’s counterclaim for breach of the implied covenant of good faith and fair dealing (“implied covenant”) in the Adobe License.⁹ (See D.I. 52)

1. Choice of Law

The Adobe License does not include a choice of law provision. Although the parties agree that Delaware choice of law rules should apply, they disagree as to the ultimate issue of which state’s law governs interpretation of the Adobe License. (See D.I. 53 at 9; D.I. 57 at 6) The Court agrees that Delaware choice of law rules are applicable. “‘The conflict of laws rules to be applied by the federal court in Delaware must conform to those prevailing in Delaware’s state courts.’” *Underhill Inv. Corp. v. Fixed Income Disc. Advisory Co.*, 319 F. App’x 137, 140

⁹PDIC asserted this counterclaim in all of the above-captioned actions, except C.A. No. 13-408, as PDIC did not respond to Adobe’s complaint in that action.

(3d Cir. 2009) (quoting *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)).

Applying Delaware choice of law rules, Adobe argues that New Jersey law should govern the Adobe License, whereas PDIC argues for Delaware law. (See D.I. 53 at 8-10; D.I. 57 at 6-7) Courts in Delaware use the “most significant relationship test” to determine which state’s law governs a contract that does not include a choice of law provision. See *Cohen v. Formula, Inc.*, 750 F. Supp. 2d 495, 501 (D. Del. 2010) (citing *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 41 (Del. 1991)). The Restatement (Second) of Conflicts of Laws (“Restatement”), used for choice of law in Delaware, instructs that a Court must search for the forum with the most significant “relationship to the transaction” – where “transaction” refers collectively to events taking place at the place of *negotiation* of the contract *and* the place of *performance* under the contract. *Cohen*, 750 F. Supp. 2d at 501 (quoting § 188 of the Restatement) (emphasis added).

The Adobe License was negotiated by Adobe in California and by PDIC in New Jersey. (See D.I. 53 at 9; D.I. 57 at 6) Adobe’s performance consisted of payment to PDIC via a bank located in New Jersey. (See D.I. 53 at 9-10; D.I. 60 at 3 n.1) This payment was the most significant affirmative act required by either party under the Adobe License, given that PDIC’s performance consisted primarily of not suing Adobe or Adobe’s customers. Adobe alleges (and PDIC does not dispute) that PDIC conducted business in New Jersey. (See D.I. 53 at 9; see also *Cohen*, 750 F. Supp. 2d at 501 (quoting Restatement’s listing of “place of business of the parties” as relevant factor for choice of law)) The only potentially relevant activity identified by the parties which took place in Delaware was litigation before this Court.

The Restatement also lists the “domicile, residence, nationality, [and] place of incorporation” of the parties as relevant factors. *Falkenberg Capital Corp. v. Dakota Cellular*,

Inc., 925 F. Supp. 231, 235 (D. Del. 1996). "Adobe is incorporated in Delaware and has its principal place of business in California. Princeton is incorporated in Texas and, though it claims its principal place of business is also in Texas . . . , it conducts business from New Jersey." (D.I. 53 at 9)

Considering all of these factors, the Court determines that New Jersey law should govern in these circumstances, primarily because a significant part of the performance and negotiation of the Adobe License took place in New Jersey. "[W]hen the place of negotiation and place of performance are in the same state, a court should generally apply the law of that state." *Falkenberg*, 925 F. Supp. at 235 (citing Restatement § 188 (1971) cmt. f). New Jersey has the most significant relationship to the transaction. Therefore, the Court will interpret the Adobe License under the law of New Jersey.

2. Implied Covenant of Good Faith and Fair Dealing

"A covenant of good faith and fair dealing is implied in every contract in New Jersey." *Wilson v. Amerada Hess Corp.*, 773 A.2d 1121, 1126 (N.J. 2001). "Although the implied covenant of good faith and fair dealing cannot override an express term in a contract, a party's performance under a contract may breach that implied covenant even though that performance does not violate a pertinent express term." *Id.* "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness." *Id.* (citing Restatement (Second) of Contracts § 205 cmt. a (1981)). "[T]he task here is to identify in that context the parties' reasonable expectations." *Id.* at 1127.

PDIC argues that Adobe breached the implied covenant by failing to “cooperate over interpretation” of the Adobe License and “supplying an unreasonable interpretation” of the Adobe License. (See D.I. 57 at 8-9) It is unclear what PDIC means by “cooperate over interpretation” of the agreement, but the Court understands PDIC’s argument to be that Adobe is advocating an unreasonable interpretation of the Adobe License. Contract interpretation is a question of law. See *Selective Ins. Co. of Am. v. Hudson E. Pain Mgmt. Osteopathic Med. & Physical Therapy*, 46 A.3d 1272, 1276 (N.J. 2012). The Adobe License expressly grants to both parties the right to enforce terms of the agreement (see D.I. 12 Ex. 2 at 3-4), which necessarily includes a right to reasonably interpret the Adobe License.

[REDACTED] (D.I. 12 Ex. 2 at 1) (emphasis added) PDIC argues that Adobe’s interpretation of the agreement “would extend licenses to products that were not ‘Licensed Products’ and beyond any remuneration received by Princeton under the Agreement.” (D.I. 57 at 11) However, in the Court’s view, the relevant terms are broad enough to render reasonable Adobe’s interpretation of the agreement as covering use of JPEG images created using Adobe’s Photoshop® product in combination with other products.¹⁰ In light of the above, the Court determines that there is no set of facts, viewing PDIC’s counterclaim in the light most favorable to PDIC, that would support a claim for relief under PDIC’s “cooperation over interpretation” theory of breach of the implied covenant.

¹⁰The Court is not called upon at this time to make a final decision as to which interpretation is the correct or most reasonable interpretation of the Adobe License.

PDIC also argues that Adobe breached the implied covenant by failing to “cooperate and supply corroborating evidence that any defendant was a customer” of Adobe and covered by the Adobe License. (See D.I. 57 at 8-9) This theory of breach of the implied covenant fails to state a claim for relief under New Jersey law because PDIC fails to plead bad faith. “Bad faith or ill motive is an essential element of a claim for breach of the implied covenant of good faith and fair dealing.” *Coldwell Banker Real Estate, LLC v. Plummer & Associates, Inc.*, 2009 WL 3230840, at *4 (D.N.J. Oct. 2, 2009) (citing *Seidenberg v. Summit Bank*, 348 N.J. Super. 243, 257 (App. Div. 2002)). PDIC argues that it pleads bad faith merely by pleading breach of the covenant of *good faith* and fair dealing. (See D.I. 57 at 11) However, the Court agrees with Adobe that such formulaic recitation of bad faith is insufficient under *Twombly*, 550 U.S. at 555.¹¹

For the foregoing reasons, the Court will grant Adobe’s Motion to Dismiss PDIC’s claim for breach of the implied covenant of good faith and fair dealing. (D.I. 52)¹²

B. PDIC’s Motion to Dismiss

PDIC moves to dismiss the patent misuse and breach of contract claims asserted by Adobe in Adobe’s complaint in intervention. (D.I. 66) PDIC moves under Rules 12(b)(1) and 12(b)(6), for lack of subject matter jurisdiction and failure to state a claim on which relief may be

¹¹PDIC’s failure to allege bad faith is an additional, independent reason why PDIC’s “cooperation over interpretation” theory, discussed above, also fails as a matter of law.

¹²PDIC requests leave to amend its counterclaim, in lieu of the Court dismissing it. (See D.I. 57 at 12) This request will be denied. Amendment would be futile. See *Forman v. Davis*, 371 U.S. 178, 182 (1962) (holding that generally leave to amend should be granted except where there is showing of, among other things, “futility of amendment”). None of the conduct PDIC characterizes as breaching the implied covenant was prohibited by the Adobe License.

granted.¹³

1. Patent Misuse

PDIC moves to dismiss Adobe's patent misuse claim based on the lack of a case or controversy. (See D.I. 68 at 10-11) Patent misuse is "the patentee's act of impermissibly broadening the physical or temporal scope of the patent grant with anticompetitive effect." *Princo Corp. v. Int'l Trade Comm'n*, 616 F.3d 1318, 1328 (Fed. Cir. 2010) (internal brackets and quotation marks omitted). "[E]xistence of a case or controversy must be evaluated on a claim-by-claim basis." *Jervis B. Webb Co. v. S. Sys., Inc.*, 742 F.2d 1388, 1399 (Fed. Cir. 1984); see also *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 352 (2006) ("[O]ur standing cases confirm that a plaintiff must demonstrate standing for each claim he seeks to press.").

In its answering brief to PDIC's motion, Adobe does not address PDIC's argument regarding lack of a case or controversy with respect to patent misuse. (See generally D.I. 77) But Adobe, as the party opposing a Rule 12(b)(1) motion, bears the burden of proving that this jurisdictional requirement is met. See *Development Fin. Corp. v. Alpha Housing & Health Care*, 54 F.3d 156, 158 (3d Cir. 1995) (stating that party asserting jurisdiction "bears the burden of showing that its claims are properly before the district court"). Under the circumstances, Adobe's failure to address whether there is any case or controversy with respect to Adobe's patent misuse claim is reason enough for the Court to dismiss Adobe's claim.

¹³Adobe argues that PDIC's motion is untimely. (See D.I. 77 at 1) However, during a teleconference with the parties on August 6, 2015, the Court authorized PDIC to file a motion to dismiss. (See Transcript (D.I. 72) at 20-21) ("So I do further authorize and direct that the due date for any renewed motion for sanctions is the same time frame I set out for the plaintiff to file a motion to dismiss . . .") Moreover, "[u]nder Rule 12(b)(1), a challenge to a federal court's subject matter jurisdiction may be brought at any time." *Singer v. Com'r of I.R.S.*, 2000 WL 14874, at *1 (E.D. Pa. Jan. 10, 2000).

Additionally, the Court agrees with PDIC. “Patent misuse is an affirmative defense to an accusation of patent infringement” *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 868 (Fed. Cir. 1997). Given that stipulations of dismissal of PDIC’s patent infringement complaint have been entered in each of the above-captioned cases, there is no longer any assertion of patent infringement in any of these cases. Nor is there any threat that PDIC will attempt to assert the ’056 patent against Adobe or against any entity in privity with Adobe.¹⁴ Nor does Adobe point to any other type of ongoing purported misuse of the ’056 patent. *See Steiner v. Lewmar, Inc.*, 2013 WL 5755578, at *5 (D. Conn. Oct. 22, 2013) (“[S]ince the Plaintiff[] ha[s] effectively waived any potential patent infringement claim, it would appear that the rationale for a patent misuse defense does not apply in this case.”).

Adobe implies that past damages resulting from misuse of the ’056 patent constitute ongoing harm from patent misuse. (See D.I. 77 at 16) (“Unless and until Princeton cures its patent misuse and the consequences have dissipated, *including making Adobe whole from the harm it has suffered* due to Princeton’s patent misuse, equity should bar Princeton from recovering for any alleged infringement of the ’056 Patent.”) The Court disagrees. First, “monetary damages may not be awarded under a declaratory judgment counterclaim based on patent misuse, because patent misuse simply renders the patent unenforceable.” *B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1428 (Fed. Cir. 1997) (internal quotation marks omitted).

¹⁴This distinguishes the situation here from that confronted in *Linzer Products Corp. v. Sekar*, 499 F. Supp. 2d 540, 560-61 (S.D.N.Y. 2007), a case on which Adobe relies for the proposition that in limited circumstances patent misuse may be brought as an independent action. (See C.A. 13-404 D.I. 77 at 13) Again, Adobe cites no authority for the proposition that there is a case or controversy or that it has standing with respect to patent misuse under the circumstances presented here.

Second, to the extent PDIC's assertion of the '056 patent may have constituted patent misuse, such misuse has now been purged by PDIC's dismissal with prejudice of all claims against Defendants in the above-captioned suits. (See D.I. 68 at 10; see also *Qualcomm Inc. v. Broadcom Corp.*, 548 F.3d 1004, 1026 (Fed. Cir. 2008) (“[A]n unenforceability remedy in the patent misuse context is limited to rendering the patent unenforceable until the misuse is purged”))

Accordingly, the Court will grant PDIC's motion to dismiss with respect to Adobe's patent misuse claim.

2. Breach of Contract

PDIC moves to dismiss Adobe's breach of contract claim for lack of subject matter jurisdiction. (See D.I. 68 at 16-20) “Jurisdiction normally attaches at the time of filing based on pleadings.” *Nilssen v. Motorola, Inc.*, 203 F.3d 782, 784 (Fed. Cir. 2000). At the time Adobe filed its complaint in intervention in each of the above-captioned cases, there was a pending case or controversy, arising under the U.S. patent laws, between PDIC and each of the individual Defendants – namely, PDIC's infringement claims related to the '056 patent. Therefore, at the time Adobe filed its complaint, the Court had subject matter jurisdiction pursuant to 28 U.S.C. § 1338.¹⁵ In addition, the Court had supplemental jurisdiction under 28 U.S.C. § 1367 over Adobe's breach of contract claims, which arise under state law.¹⁶ Adobe's breach of contract

¹⁵“The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents” 28 U.S.C. § 1338.

¹⁶28 U.S.C. § 1367(a) states, in pertinent part, “in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution.

claim is part of the same case or controversy and derives from the same “common nucleus of operative fact” as the underlying patent disputes between PDIC and Defendants. *See United Mine Workers of Am. v. Gibbs*, 383 U.S. 715, 725 (1966) (“The state and federal claims [in context of § 1367 jurisdiction] must derive from a common nucleus of operative fact.”).

Moreover, to the extent the Court has discretion to exercise supplemental jurisdiction over Adobe’s breach of contract claim, now that the underlying patent infringement disputes between PDIC and Defendants have been dismissed, the Court finds that it is appropriate to do so.¹³ The Court has already expended significant resources on these matters. It would be wasteful of judicial resources to require the parties to re-start their conflict in state court at this point.¹⁴

Accordingly, the Court will deny PDIC’s motion to dismiss with respect to Adobe’s claim for breach of contract.

C. Adobe’s Motion for Judgment on the Pleadings

Adobe moves for judgment on the pleadings on its breach of contract claim. PDIC responds that this motion is untimely for reasons including that the pleadings are not yet closed. (*See* D.I. 89 at 1–4; Fed. R. Civ. P. 12(c) (“*After the pleadings are closed* – but early enough not to delay trial – a party may move for judgment on the pleadings.”) (emphasis added)) Adobe

Such supplemental jurisdiction shall include claims that involve . . . intervention of additional parties.”

¹³28 U.S.C. § 1367(c)(3) states: “The district courts may decline to exercise supplemental jurisdiction over a claim under subsection (a) if the district court has dismissed all claims over which it has original jurisdiction.”

¹⁴Because the Court has jurisdiction over Adobe’s breach of contract claim under §§ 1338 and 1367, the Court need not address the parties’ arguments regarding the possible presence also of diversity jurisdiction under 28 U.S.C. § 1332.

admits that the pleadings are not closed and cites no authorization from the Court to file its motion at this time. (See generally D.I. 90) Accordingly, the Court will deny Adobe's motion for judgment on the pleadings.

D. Adobe's Motion for Sanctions

Adobe renewed its motion for sanctions. In its motion, Adobe moves under § 285 of the patent laws, as well as Federal Rule of Civil Procedure 11, 28 U.S.C. § 1927, and the Court's inherent authority. The Court addresses each of these potential bases for sanctions in the sections below.

1. 35 U.S.C. § 285

a. Invocation of Patent Laws

An award of attorney fees under § 285 is available in cases arising under U.S. patent laws and in non-patent cases where non-patent issues are "intertwined with the patent issues" such that "the rights at issue . . . properly invoke patent laws." *Interspiro USA, Inc. v. Figgie Int'l Inc.*, 18 F.3d 927, 933 (Fed. Cir. 1994); see also *NOVA Chemicals Corp. v. Dow Chem. Co.*, 2015 WL 5766257, at *5 (D. Del. Sept. 30, 2015).¹⁵ However, "[w]hen an action embraces both patent and non-patent claims, no fees under § 285 can be awarded for time incurred in litigation of the non-patent issues." *Gjerlov v. Schuyler Labs., Inc.*, 131 F.3d 1016, 1025 (Fed. Cir. 1997) (quoting *Machinery Corp. of Am. v. Gullfiber AB*, 774 F.2d 467, 475 (Fed. Cir. 1985)).

¹⁵PDIC has not argued that § 285 does not apply on the basis that the above-captioned cases are not patent cases or that the cases do not involve issues sufficiently "intertwined" with patent issues under *Interspiro*. Therefore, PDIC has waived this argument. See *LG Display Co. v. AU Optronics Corp.*, 2010 WL 5463305, at *4 (D. Del. Dec. 29, 2010). Nonetheless, the Court feels it is important to address this threshold issue of whether § 285 is even a proper basis on which Adobe may seek attorney fees in this case.

PDIC initiated these suits by suing Defendants for patent infringement. Adobe argues for attorney fees under § 285 based, in part, on PDIC's decision to file these suits without adequate pre-suit investigation. The adequacy of PDIC's pre-suit investigation turns on the legitimacy of PDIC's infringement theories, an issue that necessarily invokes patent law. Moreover, many (probably most) of the issues that were put before the Court in connection with Adobe's motion for sanctions – such as the plausibility or strength of PDIC's "web server infringement theory" (see D.I. 76 ¶¶ 30-36), the parties' competing interpretations of the Adobe License and what otherwise infringing acts it covers, the reasonableness of PDIC's settlement offers in light of the expiration of the patent and the impact of the patent damages statute, and the validity of the '056 patent in light of its survival of reexamination by the United States Patent and Trademark Office ("PTO") – are sufficiently "intertwined" with patent issues to "invoke patent laws" under *Interspiro*.

Therefore, the Court concludes that § 285 is applicable to the above-captioned cases and that Adobe may be able to obtain an award of attorney fees based on this statute.¹⁶

¹⁶Going forward, given the rulings announced in this Memorandum Opinion, the above-captioned cases will involve only Adobe's breach of contract claims. If either party perceives a good faith basis at the conclusion of the case to seek attorney fees under § 285, such fees will be potentially available only to the prevailing party (an issue discussed immediately below) and *only* for time spent litigating Adobe's breach of contract claim *to the extent that claim does not invoke only state law*. See *Gjerlov*, 131 F.3d at 1025 (vacating award of attorney fees for breach of contract claim that invoked only state law); see also *Gerawan Farming, Inc. v. Rehrig Pac. Co.*, 2013 WL 6491517, at *9 (E.D. Cal. Dec. 10, 2013) (limiting award of attorney fees under § 285 to claims and conduct that sufficiently invoke patent laws); *David Austin Roses, Ltd. v. Jackson & Perkins Wholesale, Inc.*, 2010 WL 555674, at *2 (D. Or. Feb. 16, 2010) (apportioning fees related to patent issues and fees related to breach of contract issues and awarding fees under § 285 for former but not for latter).

PDIC's server-level theory alleges infringement of the '056 patent by Adobe's customers but only when those customers are using non-Adobe products in implementing "on the fly" JPEG

b. Prevailing Party

PDIC argues that Adobe cannot recover attorney fees under § 285 because Adobe is not the “prevailing party.” (*See, e.g.*, D.I. 74 at 16; Tr. at 61-62) Section 285 expressly limits an award of attorney fees to the prevailing party, stating: “The court in exceptional cases may award reasonable attorney fees to the *prevailing party*.” 35 U.S.C. § 285 (emphasis added). “Federal Circuit law governs the determination of which party has prevailed.” *SSL Servs., LLC v. Citrix Sys., Inc.*, 769 F.3d 1073, 1086 (Fed. Cir. 2014).

To be a prevailing party, the Federal Circuit requires that (1) the party receive at least some relief on the merits and (2) such relief materially alter the legal relationship between the parties by modifying one party’s behavior in a way that “directly benefits” the opposing party. *See id.* “A party does not need to prevail on all claims to qualify as the prevailing party.” *Id.* “Traditionally, § 285 requests are determined by the court upon the resolution of all substantive issues in a patent case.” *Tech. Innovations, LLC v. Amazon.com, Inc.*, 2013 WL 4409462, at *3 (D. Del. Aug. 15, 2013) (citing *Highmark, Inc. v. Allcare Health Mgmt. Sys., Inc.*, 701 F.3d 1351, 1353 (Fed. Cir. 2012)). “[A] limitation exists within the statute with respect to timing such that attorney fees are properly determined under § 285 once *all* of the substantive issues in a case reach resolution.” *Id.* (emphasis added). There can only be one “prevailing party” under § 285. “Therefore, it follows that attorney fees pursued under § 285 can only be awarded after the substantive issues in the case have been resolved and the prevailing party has been determined.” *Id.*

resizing functionality. (*See* D.I. 76 ¶¶ 30-36) PDIC may be able to show that it did not breach the Adobe License by showing that use of non-Adobe products infringed under PDIC’s server-level theory. It would appear that resolution of this issue would necessarily invoke patent laws.

The proceedings involving PDIC and Adobe – as opposed to those that were initially brought by PDIC against Defendants, which have now been dismissed – are still in their early stages, as the pleadings are not even closed. Adobe's breach of contract claims remain pending and it is possible that either Adobe or PDIC may seek to amend its respective pleadings before these cases are finally decided. PDIC has prevailed against Adobe's allegations of patent misuse. Adobe has prevailed on PDIC's claim for breach of the implied covenant of good faith and fair dealing. All suits against Defendants were dismissed, vindicating Adobe's intervention in the above-captioned lawsuits to defend its customers. PDIC may have received compensation as part of settlements with some or all of the Defendants.

In light of the stage of these proceedings, and because the Court agrees with PDIC that Judge Robinson's well-reasoned analysis in *Tech. Innovations* applies to the circumstances of the instant cases (*see* D.I. 74 at 16 n.10), the Court cannot determine at this time whether PDIC or Adobe is the prevailing party. However, the Court will assume, solely for purposes of evaluating Adobe's renewed motion for sanctions, that Adobe is the prevailing party. Given that the Court will be denying Adobe's motion in any event, there is no prejudice to PDIC from the Court entertaining this assumption.¹⁷

c. Exceptional Case

Adobe argues that these cases are exceptional because: (1) PDIC failed to conduct an adequate pre-suit investigation, (2) PDIC filed and maintained baseless claims for the improper

¹⁷Should whoever turns out to be the prevailing party at the conclusion of these cases believe it has a good faith basis to file a motion pursuant to § 285, that motion will necessarily have to be based on evidence unavailable today (e.g., litigation conduct that occurs in the future). As explained below, attorney fees are not warranted under § 285 based on PDIC's claims and conduct up to this point in these cases.

purpose of extracting nuisance-value settlements, (3) PDIC maintained suits and objectively-frivolous legal positions long after becoming aware of information compelling dismissal, and (4) PDIC engaged in frivolous, wanton, and vexatious litigation conduct. (See D.I. 67 at 10-20) PDIC responds that these are not exceptional cases. (See, e.g., D.I. 30 at 17-18; D.I. 74 at 17-18; Tr. at 72)

Under the totality of the circumstances, the Court finds numerous factors that favor finding these cases exceptional, but also numerous factors pointing in the other direction. Still other considerations are neutral. The Court addresses these issues below.

I. Factors favoring finding of “exceptional” case

Adobe alleges that PDIC conducted an insufficient pre-suit investigation before suing Defendants. (See D.I. 67 at 10-13) Counsel¹⁸ for PDIC did not undertake any independent investigation but relied entirely on the pre-suit investigation of their client, Mr. Thomas Meagher, PDIC’s President, as the basis for filing suit. (See 2015 Tr. at 21-22 (The Court: “[A]ll I have is Mr. Meagher’s very short declaration if I want to understand what pre-suit investigation your client did Isn’t that correct?” Mr. Pazuniak: “With respect to a pre-suit investigation, that is correct.”); see also D.I. 31 at 1-3 (Mr. Meagher, describing his pre-suit investigation); D.I. 76 ¶¶ 30-36 (same)) Some aspects of the pre-suit investigation were deficient, which weighs in favor of making an exceptional case finding.

For example, counsel did not learn of the Adobe License prior to filing suit. As noted, counsel did not undertake any independent investigation, and so did not discover the Adobe

¹⁸These cases do not require the Court to consider the relative roles and responsibilities of Delaware counsel and non-Delaware referring counsel as, in each of these cases, PDIC is represented solely by Delaware counsel.

License on their own. Nor did PDIC or Mr. Meagher inform counsel of the existence of the Adobe License. Therefore, counsel did not consider the Adobe License before filing suit. (*See* Tr. at 42)

PDIC's Mr. Meagher had extensive experience with the '056 patent prior to PDIC filing its series of suits here in Delaware. In his earlier capacity as counsel at General Electric Company ("GE"), at a time when GE owned the '056 patent, Mr. Meagher was personally involved in licensing the '056 patent to "no less than ten (10) companies."¹⁹ (D.I. 76 ¶ 8) Mr. Meagher has declared (without dispute from Adobe) that he was "fully familiar with the '056 patent," including being familiar with licensing negotiations involving Adobe. (*Id.* at 4-11) Given Mr. Meagher's knowledge, it is striking that he did not make counsel aware of the existence of the Adobe License so counsel could evaluate its impact prior to signing 51 complaints asserting patent infringement against entities that included numerous Adobe customers, whose rights to practice the '056 patent may have been implicated by the Adobe License. Recent cases in this District discuss the significant impact meritorious license defenses can have on patent litigation. *See, e.g., Summit Data Sys., LLC v. EMC Corp.*, 2014 WL 4955689, at *5 (D. Del. Sept. 25, 2014), *aff'd sub nom. Summit Data Sys. LLC v. NetApp Inc.*, 620 F. App'x 955 (Fed. Cir. 2015) (granting attorney fees under § 285 because, *inter alia*, plaintiff brought lawsuit under theory of infringement that was barred by license); *Bayer Cropscience AG v. Dow Agrosciences LLC*, 2015 WL 1197436, at *8 (D. Del. Mar. 13, 2015) ("Bayer defends itself by claiming that it was 'unaware' that Dow had a license until Dow

¹⁹"The '056 Patent had been developed at GE, was owned by GE," and GE licensed the patent to "various companies who were practicing the patented technology." (D.I. 76 ¶ 7)

opposed Bayer's motion to amend the *Bayer I* Complaint. If that were the case, by Bayer's own admission, Bayer had a duty to investigate such license defense before filing another lawsuit."). In the circumstances here, Mr. Meagher's failure to broach the subject of a potential license defense with counsel prior to filing suit is a factor favoring finding this case to be exceptional.

Another example of deficiencies in the pre-suit investigation is that Mr. Meagher did not attempt to identify *any* suppliers of software that may have executed the JPEG functionality now accused under PDIC's "web server" theory of infringement. (See D.I. 76 ¶¶ 30-36)²⁰ Mr. Meagher indicates that he "may have encountered" a reference to "Scene7," an *Adobe* product (see D.I. 74 at 20), during his pre-suit investigation, but claims that he was "not aware that Scene7 was an Adobe company." (D.I. 76 ¶ 48) Mr. Meagher indicates that he reviewed internetretailer.com's "Internet Retailer 2008 Top 500 Guide" ("Guide") when conducting his pre-suit investigation into Defendants' websites. (See *id.* at 12) In that very Guide, there are indications that Scene7 was used in at least some of Defendants' websites – including Office Depot (for "[c]ontent [m]anagement" and "[r]ich [m]edia") and Sears Holdings Company (for "[r]ich [m]edia") (see Guide at 90, 100) – and the Guide's publisher's website, internetretailer.com, includes an article from 2007 entitled "*Imaging technology giant Adobe acquires rich media provider Scene7*" (see Kurt Peters, *Imaging technology giant Adobe acquires rich media provider Scene7*, Internet Retailer (May 3, 2007, 12:00 AM),

²⁰Under the theory of infringement PDIC argued at the May 5, 2015 hearing, images created using Adobe Photoshop® "somewhere along the line" *would not* infringe due to the Adobe License. (2015 Tr. at 29) Under PDIC's new web server theory of infringement, PDIC now implies that resized versions of images created using Adobe Photoshop® *would* infringe even under the Adobe License. (See D.I. 76 at ¶¶ 30-36) (calling such resized images "separate act[s] of infringement")

<https://www.internetretailer.com/2007/05/03/imaging-technology-giant-adobe-acquires-rich-media-provider-scene7> (last visited March 28, 2016)). As Adobe has pointed out, it acquired Scene7 in May 2007, well before the instant lawsuits were filed, and publicly announced its acquisition. (See C.A. No. 13-325 D.I. 25 Ex. 17 (Adobe-Scene7 merger agreement); C.A. No. 13-325 D.I. 22 Ex. E (press release announcing Adobe's acquisition of Scene7)) The Court is troubled that Mr. Meagher, PDIC, and its counsel wholly failed to connect *any* of the dots between Scene7, the Defendants' websites, and the Adobe License before suing Defendants.

Another factor weighing in favor of an exceptional case finding is PDIC's delay in disclosing its web server theory of infringement. In particular, PDIC waited until September 9, 2015 to disclose its web server theory in any detail. (See D.I. 76) This was 2 ½ years after filing the above-captioned cases, after Adobe had moved to intervene and had its motion granted, and after Adobe had filed *two* motions for sanctions – motions in which Adobe sought sanctions for reasons including an allegedly inadequate pre-suit investigation. Notably, Mr. Meagher's articulation of PDIC's web server theory of infringement was not included in his original (January 30, 2015) declaration describing PDIC's pre-suit investigation. (See D.I. 31) Counsel for PDIC admitted that he was "embarrassed" by the short length of Mr. Meagher's original description of PDIC's pre-suit investigation. (See Tr. at 34) While the Court credits Mr. Meagher's declaration statements²¹ that PDIC had possession of its web server theory of infringement before it filed any of the above-captioned lawsuits (see D.I. 76 ¶¶ 30-36), it would have been far preferable for PDIC to have disclosed this theory long before these cases devolved

²¹Although Adobe raises doubts about the veracity of certain portions of Mr. Meagher's second declaration (see, e.g., D.I. 85 at 2), Adobe presented no witness to dispute Mr. Meagher's statements and declined the opportunity to examine him at the hearing (see Tr. at 73).

into the protracted sanctions battle they became. Had PDIC disclosed Mr. Meagher's more detailed version of his pre-suit investigation and articulation of the web server theory of infringement during, for example, the Rule 11 safe harbor period before Adobe filed its first motion for sanctions, the parties and the Court may have been able to avoid the subsequent motions, briefing, hearings, and now opinions addressing sanctions.²² PDIC's delay in revealing the true extent of its pre-suit investigation and its detailed theory of non-Adobe infringement at the web server complicated and delayed resolution of these cases.

PDIC's inconsistent representations before the Court also weigh in favor of an exceptional case finding. At the hearing on May 5, 2015, PDIC suggested that counsel conducted no pre-suit investigation *whatsoever*, referring only to counsel's reliance on Mr. Meagher as "highly experienced patent counsel, knowledgeable patent counsel, and the referring counsel." (See D.I. 51 at 24-25) Later, in PDIC's answering brief in opposition to Adobe's renewed motion for sanctions, PDIC implied that counsel did *not* actually rely solely on Mr. Meagher, but in fact counsel *independently* reviewed claim charts and discussed matters with Mr. Meagher. (See D.I. 74 at 5) The Court accepts as true the latter representation – which depicts a far more laudable approach to meeting counsel's obligations than what was previously implied. But the lack of clarity – and arguable inconsistency – in what was explained to the

²²Even more preferable would have been for PDIC to have articulated its web server theory of infringement well prior to when Adobe served its Rule 11 motion, in connection with one or more of the repeated times when counsel for Adobe asked PDIC about its non-Adobe basis for maintaining the lawsuits. (See D.I. 67 at 5-7) Had PDIC done so, Adobe would certainly have explained to PDIC that Scene7 is an Adobe product, and the parties quite likely could have resolved their then necessarily narrowed dispute about the application of the Adobe License to Scene7 and to manipulations of images at a web server when performed with non-Adobe software.

Court contributed to the Court's May 2015 statements about the apparent inadequacy of the pre-suit investigation and likely encouraged Adobe to proceed to renew its request for sanctions, thereby extending these proceedings.

There are other inconsistencies in what PDIC has represented to the Court. In PDIC's opposition brief to Adobe's first motion for sanctions, PDIC stated that it could not access five of the nine Defendants' websites because they were either "corrupted" or "blocked." (D.I. 30 at 5-6) In other words, PDIC stated it could only access at most four of the nine Defendants' websites. Later, however, in his September 2015 second declaration, Mr. Meagher stated that as part of his early 2013 pre-suit investigation he *was* able "to eventually access at least portions of most [i.e., five or more] of the websites of the Defendants." (D.I. 76 ¶¶ 32, 34)

At the May 5, 2015 hearing, counsel for PDIC stated that PDIC would drop its lawsuits if accused images were made with Adobe Photoshop®. (See 2015 Tr. at 39-40) Later, PDIC suggested, under its new web server theory, that Defendants could still infringe even if they only used Adobe Photoshop® to create all of the accused images, so long as the "Enlarged Product View" JPEG functionality was not implemented using Scene7. (See D.I. 74 at 6; D.I. 76 at ¶¶ 30-36) The latter position appears to be inconsistent with the representation PDIC had made in May 2015. PDIC seemed to make similar inconsistent statements regarding the scope of the Adobe License. (Compare 2015 Tr. at 29-30 (stating use of Adobe Photoshop® to process image made image non-infringing under license) with D.I. 74 at 13 (stating image processed with Adobe PhotoShop® could still infringe under license)) The Court recognizes that PDIC now explains that the positions it took at the May 2015 hearing were positions it voluntarily and strategically chose to take, after deciding that rights it believed it retained under the Adobe

License were not worth fighting for in light of Adobe's intervention. (*See, e.g.*, Tr. at 101) That is, PDIC was not in fact agreeing with Adobe's interpretation of the Adobe License, and still does not agree with that interpretation. However, PDIC was far from clear about its position on these points, leading Adobe and the Court to reasonably believe that PDIC had no dispute with Adobe's position. This lack of clarity, too, made the subsequent proceedings more challenging and more demanding on the parties' and the Court's resources.

Another factor weighing in favor of an exceptional case finding is PDIC's minimal effort to develop facts (pre- or post-suit) related to infringement. Even after learning about Scene7, PDIC has produced no evidence that it has put any effort into finding out which third-party (non-Adobe) companies develop software that might be implicated by PDIC's web server theory of infringement. PDIC relied almost exclusively on Adobe and Defendants to prove that Defendants did not infringe, even though PDIC bears the ultimate burden of proving infringement. It is problematic that PDIC contracted to license Adobe and Adobe's customers, obtaining [REDACTED] in exchange, and then decided to sue some of those very customers – insisting vaguely that the suit extended only to those customers' unlicensed conduct, and requiring those customers (or Adobe) to demonstrate what was licensed.

The Court is also troubled by PDIC's delay in dismissing the Nordstrom action. (*See* C.A. No. 13-408) Adobe alleges, and PDIC does not dispute, that PDIC received a declaration from the Nordstrom Defendants (Nordstrom.com, Nordstrom.com Inc., and Nordstrom Inc.) on October 24, 2014, explaining that the Nordstrom Defendants did not infringe under the Adobe License. (*See* D.I. 67 at 6) On the basis of this declaration, PDIC eventually dismissed its case against the Nordstrom Defendants, but only *seven months later*, on May 29, 2015. (*See* C.A.

No. 13-408 D.I. 51) PDIC offers no explanation for why it took so long to dismiss the Nordstrom Defendants.

All of the above-described conduct extended litigation in the above-captioned cases and increased the resources expended on this litigation by the parties and the Court. All of these factors, therefore, favor finding these cases to be exceptional within the meaning of § 285.

ii. Factors disfavoring finding of "exceptional" case

Certain factors present here weigh against an exceptional case finding. For example, accepting as true the facts alleged by Mr. Meagher with respect to his pre-suit investigation, PDIC and its attorneys (via Mr. Meagher) performed at least *some* pre-suit investigation. As described in his declarations (D.I. 31, 76), Mr. Meagher relied on his extensive litigation and licensing experience with the '056 patent, which led Mr. Meagher to believe that "any system for creating and manipulating JPEG images infringed the '056 patent claims." (D.I. 76 ¶ 11) Accepting as true his representations, Mr. Meagher had a good faith, objectively reasonable belief that the '056 patent was valid and that systems using JPEG technology infringed the '056 patent in the manner understood by Mr. Meagher.

In addition, it was reasonable under the circumstances of these cases for counsel to rely on the extensive expertise of Mr. Meagher. Accepting as true the un rebutted representations in the declarations, counsel reviewed claim charts and had discussions with Mr. Meagher. (See D.I. 74 at 5) Moreover, counsel was entitled to rely on past communications with Mr. Meagher (including in connection with PDIC suits on the '056 patent that were filed before the earliest of the above-captioned suits) and his reputation as a "consummate expert" with respect to the '056 patent. (See, e.g., D.I. 78 at 3-5) Counsel was not required to redo the investigative steps

performed by Mr. Meagher before filing the lawsuits.²³ Counsel obviously had no control over the fact that Mr. Meagher did not disclose to them the existence of the Adobe License or its potential relevance. This pre-suit investigation, although incomplete and far from ideal, was adequate under the circumstances to meet counsel's Rule 11 obligations (as further discussed below).

The Court accepts on this record that Mr. Meagher and PDIC possessed a plausible theory of infringement under a reasonable interpretation of the Adobe License. As noted above, the statements by PDIC's counsel that created apparent inconsistencies with respect to PDIC's license and infringement theories do not demonstrate that PDIC ever actually conceded the incorrectness of PDIC's positions or ever actually conceded the correctness of Adobe's alternative positions. (*See, e.g.*, Tr. at 16-18) Relatedly, although PDIC delayed in revealing the details of its web server theory, nothing about the theory is inconsistent with Adobe and PDIC's joint letter sent to Adobe's customers. (D.I. 69-1 Ex. 9) In addition, PDIC's original complaints in these cases discuss infringement at the level of websites (albeit in a very general fashion). (*See* D.I. 1)

Moreover, there are indicia in the record that PDIC's web server theory of infringement is not merely plausible but may actually be a strong basis for asserting unlicensed infringement of

²³PDIC quotes *CTC Imports & Exports v. Nigerian Petroleum Corp.*, 951 F.2d 573, 579 (3d Cir. 1991), for the proposition that PDIC was not required to conduct as full of a pre-suit investigation in these cases as would have been required if the '056 patent had not been expired and had PDIC's damages period not been shrinking by the day. (*See* D.I. 74 at 15) The Court disagrees with PDIC that *CTC* supports this proposition. Mr. Meagher stated in his declaration (D.I. 76 ¶ 9) that PDIC acquired the '056 patent in January of 2010. Thus, it was PDIC's own delay that created the supposedly emergent situation pointed to by PDIC, and PDIC cannot use a situation of its own creation as an excuse for any deficiencies in its pre-suit investigation.

the '056 patent by one or more of the Defendants. The record demonstrates that at least some of the Defendants do not rely exclusively on Scene7 in the web servers. (See D.I. 74 at 5) Adobe is silent in its briefing on the relative merits of PDIC's web server theory. Adobe has not presented any evidence – expert or otherwise – to challenge the merits of this infringement theory.²⁴

It is notable, as well, that the presumption of patent validity which is always present at the start of a patent infringement suit is here, with respect to the '056 patent, a quite strong presumption. This is because of the many licenses third-party entities have taken to the '056 patent and the '056 patent's survival of reexamination in the PTO. (See D.I. 76 ¶¶ 8, 17) Adobe has not suggested that it has an untested, meritorious theory as to why the '056 patent is invalid.

Regarding PDIC's license position, PDIC has repeatedly asserted that it is only seeking recovery for infringement *not* covered by the license (i.e., infringement not involving Adobe products) in light of the following language in the Adobe License: [REDACTED]

[REDACTED] (D.I. 76 ¶ 23) (emphasis added) Again, the Court does not view PDIC's interpretation of the Adobe License – a position PDIC chose not to fight for in the context of its patent infringement allegations against Defendants, after Adobe intervened, but a position PDIC has never abandoned as what it views as the correct reading of the Adobe License – to be unreasonable.

²⁴Adobe essentially argues that PDIC formulated the web server infringement theory too late (after filing suit) and/or that PDIC waived its right to proceed on this theory by concessions it had made earlier in the litigation. Adobe does *not*, however, make any attempt to show that the web server theory of infringement is erroneous, implausible, or frivolous.

As indicated by Mr. Meagher, when PDIC received statements from Defendants that they only used Adobe products with respect to the accused technology, PDIC dismissed its cases against these Defendants. (See D.I. 76 ¶ 52) Accepting Mr. Meagher's representations as true, PDIC did not advocate positions that were meritless or frivolous. Nor should it be overlooked that when PDIC learned of Adobe's position with respect to the Adobe License, PDIC worked with Adobe to agree on the text for a letter that Adobe sent to Adobe's customers, advising those customers that PDIC was not suing based on Adobe-related conduct. (See D.I. 30 at 2) PDIC's cooperation with Adobe in this undertaking disfavors finding PDIC's litigation conduct exceptional.

What follows from all of this is the very significant fact that even a more thorough pre-suit investigation may well not have led counsel to conclude that these cases should not have been filed. Importantly, given the plausible (and possibly strong) theory of unlicensed infringement of a valid patent that has been (belatedly) articulated by PDIC, it is difficult for the Court to conclude that these cases are of a type that the Court should seek to deter from being filed. That conclusion weighs heavily against a finding of exceptionality.

In light of the above, the Court is not persuaded that these suits were brought for an improper purpose or that the suits were frivolous.

iii. Neutral factors

Other circumstances present in these cases are relevant to the exceptional case analysis, but are neutral and do not weigh for or against a finding of exceptionality.

Adobe emphasizes the total number of 51 "nearly identical" lawsuits brought against Defendants and others alleging the same theory of infringement under the '056 patent. As Adobe

correctly observes, the Federal Circuit has explained that a “pattern of filing nearly identical complaints against a wide variety of companies” can be “one indicia” of a lawsuit having an “improper purpose.” *Eon-Net LP v. Flagstar Bancorp.*, 249 F. App’x 189, 197 (Fed. Cir. 2007). But in the cases now before the Court, the record strongly suggests that the ’056 patent was a relatively broad, strong patent covering many uses of JPEGs, an undisputedly popular technology. (See D.I. 76 ¶¶ 7-17) Hence, the large number of cases filed by PDIC may just as likely reflect widespread infringement of a valid patent, rather than be indicative of abuse of the judicial system for an improper purpose.

Adobe also points to the “nuisance” (i.e., low) value settlement offers PDIC made to Defendants in attempting to settle these cases at an early stage. (See D.I. 67 at 14-15) Low value settlement offers, too, have been found by the Federal Circuit to sometimes be part of “exploiting the high cost to defend complex litigation.” *Eon-Net LP v. Flagstar Bancorp.*, 653 F.3d 1314, 1327 (Fed. Cir. 2011). Nonetheless, Adobe has pointed to no authority for its implicit position that sums sought in settlement must exceed a certain minimum dollar figure in order to qualify as “non-nuisance” offers. More importantly, here it appears equally plausible that PDIC – and Mr. Meagher particularly – knew that any *non-nuisance reasonable* settlement offer had to be for a fairly low dollar figure. The ’056 patent expired on December, 8 2007; given the six-year statutory limit on recovery of patent infringement damages, *see* 35 U.S.C. § 286, this meant that PDIC could only seek to recover damages accrued up to December 8, 2013. Given that the earliest-filed of the above-captioned cases was filed on February 15, 2013 (*see* C.A. No. 13-239 D.I. 1), PDIC’s best-case recovery if it prevailed in the litigation was just under ten months of damages. In this context, the record is not developed to a point where the Court could find that

the low value settlement offers were nuisance offers or instead that they were reasonable offers tailored to the facts here.

Finally, Adobe argues that the fact that PDIC's settlement offers were "exploding" – that is, they were "on the table" for only a limited period, after which they were withdrawn – further evidences PDIC's improper purpose. Federal Circuit precedent has noted "demand for a quick settlement" can support a finding of exceptionality. *Eon-Net LP*, 653 F.3d at 1327. But in the above-captioned cases, because the patent-in-suit was long-expired, the damages available to PDIC were shrinking by the day. Time was of the essence. Furthermore, PDIC, as a small company, may have desired to settle some or all of the suits quickly due to the high costs of maintaining litigation in 51 patent suits.

In short, the number of cases and terms of settlement offered by PDIC *may* favor the above-captioned cases being found exceptional, but they equally *may not* favor such a finding. In the Court's view, under the circumstances present here, these factors are neutral.

iv. Conclusion with respect to "exceptional" case

As should be clear from the lengthy discussion above, whether the above-captioned cases should be found "exceptional" within the meaning of § 285 presents a difficult, close call. Many factors favor a finding of exceptionality, while many do not, and still others – including factors relied on heavily by Adobe – are neutral in the balance. But the law requires the Court to make a finding one way or the other.

Under a totality of the circumstances analysis, the Court finds that these cases do "stand out from the rest," in comparison to the full panoply of patent cases with which the undersigned has been involved. Indeed, the above-captioned cases are "uncommon," "rare," and "not

ordinary.” *Octane Fitness*, 134 S.Ct. at 1756. Therefore, these cases are “exceptional” within the meaning of § 285.

The Court makes this finding not due to the lack of merit to PDIC’s case, nor due to bad faith litigation conduct. Instead, these cases “stand out from the rest” due to a combination of: an adequate but far from ideal pre-suit investigation, conducted with haste due to decreasing damages availability based on an expired, but seemingly strong and broad, patent; somewhat careless, dilatory litigation conduct by the patentee; an attempt by the patentee to shift some substantial portion of the costs of identifying the line between licensed and non-licensed conduct to Defendants and Adobe; intervention, permitted by the Court, by an aggressive intervenor, despite PDIC’s repeated (though at times hard-to-believe) protestations that PDIC had no intent to accuse any licensed conduct of infringement; PDIC’s unexplained delay in dismissing at least one of the above-captioned cases; and PDIC’s failure to carefully, consistently, and thoroughly respond to Adobe’s reasonable inquiries as well the Court’s questions. The overall balance, therefore, leads the Court to find that these cases are “exceptional.”

d. Court’s Discretion as to Whether to Award Fees

The finding that these cases are “exceptional” makes an award of attorney fees available, but it does not compel such an award. Section 285 provides: “The court in exceptional cases *may* award reasonable attorney fees to the prevailing party” (emphasis added). *See also Cimline, Inc. v. Crafcø, Inc.*, 2010 WL 2545884, at *3 (D. Minn. June 21, 2010) (“Even an exceptional case does not require in all circumstances the award of attorney fees.”) (citing *S.C. Johnson & Son, Inc. v. Carter-Wallace, Inc.*, 781 F.2d 198, 201 (Fed. Cir. 1986)). The Court has decided that the appropriate exercise of its discretion under the totality of circumstances is not to award

attorney fees.

As the Supreme Court stated in *Octane Fitness*, 134 S. Ct. 1756 n.6, “considerations of compensation and deterrence” may inform the § 285 analysis. Regarding considerations of compensation, the Court notes that Adobe has chosen to litigate these cases aggressively, including by intervening, by persisting with litigation even after PDIC dismissed all of its patent infringement allegations against Defendants, and by filing a motion for judgment on the pleadings before the pleadings were even closed. In view of Adobe’s litigation choices, a significant portion of Adobe’s attorney fees are attributable to *Adobe’s* actions, and not PDIC’s. While certain of PDIC’s litigation conduct extended litigation in these cases and increased the amount of resources expended by the parties and the Court, this is not one of the “rare” cases “in which a party’s unreasonable, though not independently sanctionable, conduct is *so* ‘exceptional’ as to justify an award.” *Octane Fitness*, 134 S. Ct. at 1751 (emphasis added).

With respect to considerations of deterrence, although PDIC could have done more to advance the litigation much more efficiently, there is no singular category of conduct that rises to a level that would warrant deterrence by way of an award of attorney fees. There is no evidence of bad faith or otherwise sanctionable conduct. In many ways, PDIC’s somewhat careless and dilatory conduct was a result of the unique circumstances of these cases, involving an aggressive third-party intervenor, ~~two~~ motions for sanctions before the case even got to the discovery phase, and a flurry of motion practice based on wholly-undeveloped theories of license interpretation and patent infringement.

For the above reasons, Adobe’s request for attorney fees under § 285 will be denied.

2. Rule 11

Based on PDIC's most recent submissions to the Court, the Court cannot say that PDIC's pre-suit investigation was inadequate or that any filing was made for any improper purpose or without a reasonable factual or legal inquiry taking place prior to the filing. The substantive merit of PDIC's lawsuits is sufficient under Rule 11, and the Court has already determined that the suits were not brought for an improper purpose. Thus, for the reasons stated above, sanctions under Rule 11 will be denied.

3. 28 U.S.C. § 1927

Sanctions under § 1927 require a finding of bad faith. *See Prudential*, 278 F.3d at 188. "Indications of this bad faith are findings that the claims advanced were meritless, that counsel knew or should have known this, and that the motive for filing the suit was for an improper purpose such as harassment." *Id.* While PDIC's lawsuits were ultimately dismissed, the Court finds that PDIC was not pursuing these actions in bad faith or for an improper purpose, for the reasons already discussed above. Therefore, sanctions under § 1927 will be denied.

4. Court's Inherent Authority

A finding of bad faith is usually required for sanctions under the Court's inherent authority. *See Prudential*, 278 F.3d at 188. For the reasons discussed above, the Court has not found bad faith and does not deem the accused conduct sanctionable under the Court's inherent authority. "Generally, a court's inherent power should be reserved for those cases in which the conduct of a party or an attorney is egregious and no other basis for sanctions exists." *Martin v. Brown*, 63 F.3d 1252, 1265 (3d Cir. 1995). Neither PDIC nor PDIC counsel's behavior was egregious. PDIC has not acted in bad faith, vexatiously, wantonly, or for oppressive reasons.

Therefore, sanctions under the Court's inherent authority will be denied.

IV. CONCLUSION

For the foregoing reasons, the Court will (1) grant Adobe's Motion to Dismiss (D.I. 52), (2) grant in part and deny in part PDIC's Motion to Dismiss (D.I. 66), (3) deny Adobe's Motion for Judgment on the Pleadings (D.I. 75), and (4) deny Adobe's Renewed Motion for Sanctions (D.I. 65). An appropriate Order follows.