Kevin M. Lippman
MUNSCH HARDT KOPF & HARR, P.C.
4000 Fountain Place
1445 Ross Avenue
Dallas, Texas 75202
Telephone: (214) 855-7553
Telecopier: (214) 978-4335

Lawrence P. Eagel
BRAGAR WEXLER EAGEL & MORGENSTERN, P.C.
885 Third Avenue, Suite 3040
New York, New York 10022
Telephone: (212) 308-5858
Telecopier: (212) 486-0462

Attorneys for Aerotel, Ltd.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	Chapter 11
	§	
VARTEC TELECOM, INC., *et al.*,	§	Case No. 04-81694-HCH
	§	
Debtors.	§	(Jointly Administered)
	§	

MOTION OF AEROTEL, LTD. FOR ORDER WITHDRAWING THE REFERENCE OF ITS PATENT INFRINGEMENT CLAIMS AND SUPPORTING MEMORANDUM OF LAW

TO THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS:

PRELIMINARY STATEMENT

Aerotel, Ltd. ("Aerotel") respectfully submits this motion ("Motion") and supporting memorandum of law, pursuant to 28 U.S.C. § 157(d), Federal Rule of Bankruptcy Procedure 5011(a), and Local Bankruptcy Rule 5011.1, for an Order withdrawing the reference of Aerotel's claims of patent infringement against Vartec Telecom, Inc. and certain related entities (collectively the "Debtors") from the United States Bankruptcy Court for the Northern District of Texas (the "Bankruptcy Court").

Aerotel has asserted federal patent infringement claims against the Debtors arising out of the Debtors' pre and post-petition infringement of Aerotel's patent rights conferred by U.S. Patent No. 4,706,275 (the "'275 Patent") from the sale, offer for sale and use of "Prepaid Calling Card" products and/or services as defined in the '275 Patent. Aerotel has timely filed proofs of claim against Vartec Telecom, Inc. and the other Debtors which, in the aggregate, exceed $141,000,000. On August 26, 2005, the Debtors objected to Aerotel's claims.

Pursuant to 28 U.S.C. § 157(d), withdrawal of the reference is mandatory because resolution of Aerotel's claims involve consideration of non-bankruptcy federal statutes affecting interstate commerce, including the United States patent laws. Even if mandatory withdrawal were not warranted, the proceeding to adjudicate the patent infringement claims should be withdrawn as a matter of discretion under the "for cause" provision of § 157(d). As discussed below, judicial economy, the prevention of forum shopping, and Aerotel's right to have its patent claims adjudicated by a jury all provide good cause to withdraw the reference.

NATURE AND STAGE OF PROCEEDINGS

On November 1, 2004 (the "Petition Date"), the Debtors each filed voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101, et seq. (the "Bankruptcy Code"), thereby initiating this Bankruptcy Case and creating the Debtors' bankruptcy estate (the "Estate"). Debtors' bankruptcy cases are jointly administered under Case No. 04-81694-HDH-11.

The Bankruptcy Court set March 14, 2005 as the last date for parties who have or assert claims against one or more of the Debtors to file a Proof of Claim. On February 24, 2005, Aerotel timely filed Proofs of Claim against Vartec Telecom, Inc. and each of the other Debtors which, in the aggregate, exceeds $141,000,000 (the "Proofs of Claim"). *See* Exhibit A to Lawrence P. Eagel

Affidavit in Support of the Motion to Withdrawing the Reference of Its Patent Infringement Claims (the "Eagel Aff. The basis of Aerotel's claim is for the Debtors' pre-petition patent infringement of Aerotel's patent for the sale, offer for sale, and use of Prepaid Calling Cards products and/or services.

In addition, on May 10, 2005, Aerotel filed proofs of claim for administrative expenses against Debtors, arising out of Debtors' post-petition infringement of the '275 Patent (the "Administrative Expense Claim"). *See* Eagel Aff., Ex. B.

Aerotel's efforts to obtain information from the Debtors' informally and to discuss and resolve its claims have been rebuffed. *See, e.g.,* Eagel Aff., Ex. C.

On August 26, 2005, the Debtors objected (the "Objection") to Aerotel's Proofs of Claim on the ground that (i) certain Debtors identified in the Proofs of Claim never provided any Prepaid Calling Card or services, and (ii) Debtors' business did not involve infringing prepaid calling card technology. *See, e.g.,* Eagel Aff., Ex. D.

By this Motion, Aerotel requests that this Court withdraw all proceedings arising from the Debtors' objection to Aerotel's Proofs of Claim and Administrative Expense Claim from the Bankruptcy Court insofar as those claims relate to determining the validity and enforceability of Aerotel's pre and post-petition patent infringement claims, the amount of damages payable to Aerotel on account of the Debtors' infringement of the '275 Patent, and any ancillary relief which may be appropriate under the circumstances.

BACKGROUND FACTS

The '275 Patent

Aerotel is a corporation incorporated under the laws of Israel, with its principal place of business in Holon, Israel. Aerotel is the owner of the '275 Patent which was conferred by U.S.

Patent No. 4,706,275 issued on November 10, 1987 to Zvi Kamil, and all corresponding foreign patents, for an invention titled "Telephone System"; *i.e.*, the '275 Patent.

The '275 Patent describes a system and method for what is known to the parties as a "Prepaid Calling Card." The invention of the '275 Patent is directed to systems and methods for providing telephone service to customers who have prepaid for that service. In summary, prepayments are made by purchasing Prepaid Calling Cards, tickets or services. For example, calling cards or tickets may be purchased at point-of-sale locations, such as hotels, airports, car rental agencies and the like. In the prepayment transaction, the customer pays a predetermined amount and receives a Prepaid Calling Card having an associated authorization code (referred to as a "special code"). The authorization code and the prepayment amount are then stored in memory at a "special exchange". This stored data is used to process telephone calls of prepaid customers who call up the "special exchange". The "special exchange" can be accessed from any available telephone.

The "special exchange" comprises a computer programmed with software, memory for storing data and a telephone call router.[1] In particular, the memory stores the aforementioned authorization codes (*i.e.*, PIN numbers) and prepayment balances associated with those authorization codes. The computer is programmed to process prepaid telephone calls. To accomplish this, the computer performs functions, such as validating inputted authorization codes, verifying that the stored prepayment balances associated with validated authorization codes are sufficient to make the call requested, and monitoring the duration of the call after a connection is

[1] "[R]outing" is technically defined as "[t]he assigning and establishing of a path for sending information between stations of a communications network." *McGraw-Hill Dictionary of Scientific and Technical Terms* (1974), PX 2 at 1282.

made. The telephone call router routes the call toward its destination station in response to instructions from the computer.

In accordance with the methods disclosed and claimed in the '275 Patent, when the prepaid customer desires to make a call using an authorization code, the prepaid customer (*i.e.*, the calling party) first dials a telephone number to access or reach the special exchange. After the calling party is connected with the special exchange, the calling party inputs his/her authorization code. That code is checked by the computer to ensure that it is a validly issued authorization code. The caller also inputs the destination phone number he/she wishes to call. The computer determines how much the call will cost and checks whether the prepaid balance associated with the inputted authorization code is sufficient to make such a call. If the balance is sufficient, the computer instructs the router to route the call to the destination station. If the balance is insufficient, the call is not permitted.

The computer at the special exchange is programmed to monitor connected calls while they are ongoing. The purpose of such monitoring is to prevent the cost of the call from exceeding the amount of money which has been prepaid by the customer. When the prepaid amount has been spent, the call is disconnected, *i.e.*, cut off, and further calls using the same authorization code are prevented unless an additional prepayment is made. On the other hand, if the caller hangs up before the prepayment has been spent, the credit balance is reduced by the cost of the call.

Debtors' Infringement

The Debtors sold Prepaid Calling Cards and services which infringed upon the '275 Patent prior to the Petition Date, and continue to sell these products as part of their post-petition operations. Aerotel expects to receive discovery responses which will enable it to determine the extent of this infringement. In their Objection, the Debtors' do not dispute that one or more of the

Debtors sold and continued to sell Prepaid Calling Cards and services which in fringed upon the '275 Patent.

Aerotel's Proofs of Claim

Aerotel has asserted claims against the Debtors arising out of the Debtors' infringement of the '275 Patent through the sale, offer for sale and use of Prepaid Calling Card products and/or services as defined in the '275 Patent. Based upon the information, nature and scope of the Debtors' businesses, Aerotel believes that its claims against the Debtors equals or exceeds $141,000,000.

The information to determine the amount of the Debtors' Gross Sales Receipts is exclusively within the dominion and control of the Debtors. In general, Aerotel calculated its damages based upon a royalty rate of 4.7% of the Debtors' Gross Sales Receipts, which is the total compensation received by the Debtors for the sale and or use of Prepaid Calling Cards and services. The 4.7% royalty rate is consistent with a damages claim Aerotel has made in litigation commenced by Aerotel for infringement of the '275 Patent. The 4.7% royalty rate is higher than the royalty rates Aerotel has charged to willing licensees of the '275 Patent in the case of past infringement because Aerotel is being forced to litigate its claim for infringement.

Presently, Aerotel licenses the same technology and services for which claims have been asserted against the Debtors to AT&T Corp., Verizon Corp., Sprint, MCI, and NTT Communications, Inc., among others.

ARGUMENT

WITHDRAWAL OF THE REFERENCE IS APPROPRIATE UNDER THE CIRCUMSTANCES

A. Aerotel's Patent Claims Should be Withdrawn Under the "Mandatory" Prong

Section 157(d) of Title 28 provides for both the "mandatory" and "permissive" withdrawal to the District Court of the reference of an action from the Bankruptcy Court.[2] Specifically, § 157(d) provides:

> The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

28 U.S.C. § 157(d) (emphasis supplied). Withdrawal of the reference is mandated in this case because this proceeding requires substantial consideration of federal statutes governing the ownership and use of intellectual property.

Pursuant to the § 157(d), the district court "shall" withdraw a proceeding if the resolution requires consideration of both title 11 and other laws regulating organizations or activities affecting interstate commerce.[3] In addition, mandatory withdrawal is required for "cases or issues

---

[2] Title 11 cases may be referred to bankruptcy judges pursuant to 28 U.S.C. § 157(a). In the Northern District of Texas, "cases under title 11 and any or all proceedings arising under Title 11 or arising in or related to a case under Title 11" are automatically referred to the bankruptcy court pursuant to a Standing Order dated August 3, 1984.

[3] As noted in the leading treatise on bankruptcy law, the mandatory withdrawal provision reflects congressional intent that bankruptcy judges should not hear the types of matters that fall outside the scope of their expertise, except in certain limited circumstances. 1 *Collier on Bankruptcy* ¶ 3.04[2] (15th ed. 1999). The legislative history demonstrates this intent. In the floor debate on the 1984 legislation, Representative Kramer asked Representative Kastenmeier about the operation of § 157(d):

> Representative Kramer: The language "activities affecting interstate commerce" is very broad language. What kinds of situations or circumstances does the gentleman intend to cover here? Or will this language become an escape hatch through which most bankruptcy matters will be moved to a district court.
>
> Representative Kastenmeier: This language is to be construed narrowly. It would, for example, mean related causes which may require consideration of title 11 issues and other Federal laws including cases involving the

that would otherwise require a bankruptcy court judge to engage in significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statutes." *City of New York v. Exxon Corp.,* 932 F.2d 1020, 1026 (2d Cir. 1991) (Injunction of further proceedings in the Bankruptcy Court was granted. Claims were subject to the mandatory provision of § 157(d) because the case required the Court to interpret the City's claims under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) 42 U.S.C. § 9601 *et seq.*), *see also, McCrory Corp. v. 99 Cents Only Stores,* 160 B.R. 502 (S.D.N.Y. 1993), *In re National Gypsum Company,* 145 B.R. 539 (N.D. Tex. 1992).

In *In re National Gypsum Company,* a closely analogous case, a creditor, U.S. Gypsum, moved pursuant to 28 U.S.C. § 157(d) to withdraw the reference of its proof of claim, amended proof of claim and the debtor's objection to the claim based upon the fact that is claim arose out of a patent infringement suit. *National Gypsum Company,* 145 B.R. at 540. In granting the motion, the district court held that mandatory withdrawal was appropriate because § 157(d) applied to patent claims, patent infringement claims were complex and involved substantial and material questions of non-bankruptcy code federal law, and the determination of the patent laws would have more than a *de minimis* effect on interstate commerce. *Id.* at 541-542. *See also Lifemark Hospitals of Louisiana, Inc. v. Liljeberg Enterprises, Inc.*, 161 B.R. 21 (E.D. La. 1993) (antitrust violations involved in the case required "significant interpretation" of non-bankruptcy federal law, mandating withdrawal of the reference) (citing *National Gypsum Company,* 145 B.R. at 541).

> National Labor relations Act, civil rights laws, Securities and Exchange Act of 1934, and similar laws.

130 Cong. Rec. H. 1850 (daily ed. March 21, 1984) (emphasis added) (quoted in 1 *Collier on Bankruptcy* ¶ 3.04[2], fn. 7); *see also, In re American Solar King Corp.*, 92 B.R. at 211 (W.D. Tex. 1988) (quoting Representative Kastenmeier's statement).

For the same reasons, mandatory withdrawal applies to the facts of this case. Aerotel asserts patent infringement claims against the Debtors arising out of the Debtors' infringement of the '275 Patent. As set forth above, the '275 Patent is for a telephone system which enables prepayment for telephone calls using a special code and credit information which is stored in memory in special exchanges and as the calls are possessed the amounts are debited. The extent to which the Debtors infringe on Aerotel's patent rights will require the court to engage in "significant interpretation" of federal patent laws and rules, respectively 35 U.S.C. § 100 *et seq.* § 271 *et seq.* § 280 *et seq.* and 37 C.F.R. § 1.56 *et seq.* Therefore, since resolution of this dispute will require more than a simple application of the non-bankruptcy laws, this dispute should be withdrawn to the district court. *See Id., see also The Singer Company, N.V. v. Groz-Beckert KG,* 2002 WL 243779 at *3 (S.D.N.Y. 2002), *In re Johns-Manville Corporation,* 63 B.R. 600 (S.D.N.Y. 1986).

In *The Singer Company,* the court held that withdrawal was mandatory "because resolution of the adversary proceeding requires substantial and material consideration of domestic patent law, a statutory creation." *The Singer Company,* 2002 WL 243779 at *3. Moreover, the patent law issues were central to the complaint and the court would have to determine the difficult patent law question as to whether an implied patent could arise under the circumstances. *Id.* Thus, the court stated that,

> determining whether an accused product infringes a patent requires significant and material consideration of patent law…[and] requires a two-step analysis in which the court must construe the disputed patent claims and then apply the construed claims to the accused device. The claim construction itself requires a hearing, followed by the court's examination of the intrinsic evidence (the words of the patent itself), the prosecution history, if in evidence, and in some instances extrinsic evidence.

Id. (citation omitted). The court concluded that it made "little sense for the bankruptcy court to interpret the patent claims, and then have the district court preside over a jury trial centered on those claims. *Id.* at *4.

Here, as in *The Singer Company*, federal patent laws are essential to determining Aerotel's dispute which revolves around whether the Debtors infringed upon the '275 Patent. The Debtors challenge the validity and enforceability of the '275 Patent under Title 35 of the United States Code. Thus, Aerotel's patent infringement case will require the court to determine whether the patent is valid under the applicable patent laws prior to determining whether the Debtors' sale, offer for sale and use of Prepaid Calling Cards amounts to infringement of Aerotel's '275 Patent. Under these circumstances, § 157(d) mandates withdrawal of the reference. *The Singer Company*, 2002 WL 243779, *City of New York,* 932 F.2d 1020.

B. Aerotel's Patent Claims Should Also Be Withdrawn Under the "Permissive Prong"

Aerotel respectfully submits that mandatory withdrawal applies to the facts of this case. However, good cause also exists to withdraw the reference in these circumstances.

Pursuant to §157(d) the court "may" withdraw the reference "for cause shown." In determining whether discretionary withdrawal of the reference is appropriate, district courts are to consider such factors as: (i) judicial economy, (ii) convenience, (iii) the particular court's knowledge of the facts, (iv) promoting uniformity and efficiency of bankruptcy administration, (v) reducing forum shopping, (vi) conserving debtor and creditor resources, (vii) whether parties are entitled to a jury trial, and (viii) whether the claims involved are 'core' bankruptcy proceedings. *See In re Lincoln*, 2005 Bankr. LEXIS 1152 (N.D. Tex. 2005) (citations omitted).

Although Aerotel's Proofs of Claim fall within the definition of a "core proceeding" under 28 U.S.C. § 157, that factor is not entitled to great weight. Aerotel had no choice but to file the

Proofs of Claim; the alternative was to risk losing its claims altogether. Aerotel did include in its Proofs of Claim a specific disclaimer concerning any adjudication of its patent rights.[4] Under the circumstances, Aerotel should not be forced to adjudicate its claims in a forum that does not normally adjudicate claims of this nature. Aerotel's patent claims plainly do not involve any unique knowledge or expertise that would otherwise support having the claim adjudicated in the Bankruptcy Court.

In determining the basis of "core" or "non-core" in the context of withdrawal of the reference, the courts analyze the basis on which the proceeding is predicated. "To be a core proceeding an action must have as its foundation the creation, recognition, or adjudication of rights which would not exist independent of a bankruptcy environment." *Holloway v. HECI Exploration Co. Employees' Profit Sharing Plan*, 76 B.R. 563, 568 (N.D. Tex. 1987) (citations omitted). *See also Morshet Isael, Inc.,* 1999 WL 165699 at *2 (S.D.N.Y. March 24, 1999) ("A proceeding that involves rights created by bankruptcy law, or that could only arise in a bankruptcy case, is a core proceeding.") (*citing In re Green,* 200 B.R. 296, 298 (S.D.N.Y. 1996)). By contrast, a non-core proceeding for this purpose does not depend on bankruptcy laws for its existence and can proceed in a court that lacks federal bankruptcy jurisdiction. *Moshet Isael, Inc.,* 1999 WL 165699 at *2.

The court in *McCrory Corp.* relied on the following reasoning to determine that withdrawal was warranted in a case involving trademark claims:

> "A proceeding is encompassed within the bankruptcy court's core… 'if it invokes a substantive right provided by title 11 or if it is a proceeding that, by nature, could arise only in context of a bankruptcy case.'" *McCrory Corp.,* 160 B.R. at 56 (*citing Silverman v. General Ry. Signal Co.,* 144 B.R. 244, 249 (Bankr. S.D.N.Y. 1992); *accord Acolyte Elec. Corp. v. City of New York,* 69 B.R. 155, 173 (Bankr. E.D.N.Y. 1986) ("To be a core proceeding, an action

[4] In each of its Proofs of Claim, Aerotel included a reservation of its rights to seek withdrawal of the reference. Thus, in each claim, Aerotel states: "[B]y filing this request, Aerotel does not waive its right to contest the Bankruptcy Court's jurisdiction to determine the validity, enforceability or infringement of the 275 Patent."

> must have as its foundation the creation, recognition, or adjudication of rights which would not exist independent of a bankruptcy environment.")

McCrory Corp., 106 B.R. at 505.

In addition, Aerotel should not be deprived of its important right to a jury trial where the issue involves the validity and enforceability of its patent rights under the '275 Patent. The right to a jury trial is an important consideration in determining whether cause exists to withdraw the reference. *See In re Dooley Plastic Co. Inc.,* 182 B.R. 73, 81 (D. Mass. 1994) (granting the motion to withdraw the reference of an adversary proceeding, which was clearly a core-proceeding, because the Bankruptcy Court's lack of authorization to conduct a jury trial constituted good cause for withdrawing the reference.)

In *McCrory Corp.,* the court stated that it was "economically and administratively prudent for a district judge, experienced in trademark law, rather than a bankruptcy judge to handle these matters." *McCrory Corp.,* 160 B.R. at 506-507. In this case, the interests of judicial economy favor withdrawal of the reference because district court judges have more experience in patent infringement law.

C. Aerotel's Motion to Withdraw the Reference is Timely

Aerotel has made a timely motion to withdraw the reference under 28 U.S.C. § 157(d). Section 157(d) does not provided a specific time limit for motions to withdraw the reference from the bankruptcy court. Therefore, the courts will look to see if the motion was made "as timely as possible in light of the status of the bankruptcy proceeding." *See In re Texaco Inc.,* 84 B.R. 911, 919 (S.D.N.Y 1988); *see also, The Singer Company,* 2002 WL 243779 at *3; *Lone Star Industries, Inc. v. Rankin County Economic Development District,* 158 B.R. 574 (S.D.N.Y. 1993); *In re Giorgio*, 50 B.R. 327 (D.R.I. 1985) (the court will interpret "timely as being at the first reasonable

opportunity.") This standard is applied on a case-by-case basis in light of the circumstance of each individual bankruptcy case. In *In re National Gypsum Company,* the court held that the motion to withdraw the reference would have been premature until after the objection to the proof of claim was made and that under the circumstances the motion filed 33 days after the objection was filed was timely. *In re National Gypsum Company,* 145 B.R. 539, 542 (N.D. Tex. 1992).

The Debtors' Objection to Aerotel's patent infringement claims was filed on August 26, 2005. This Motion has been filed promptly after that date. There has been no meaningful litigation activity other than the filing of the claims, and the recently filed Objection. Under the circumstances, this Motion is timely.

CONCLUSION

For the foregoing reasons, Aerotel's respectfully requests that the reference of the patent infringement claims to the Bankruptcy Court be withdrawn pursuant to 28 U.S.C. § 157(d).

Respectfully submitted,

MUNSCH HARDT KOPF & HARR, P.C.

By: /s/ Kevin M. Lippman
Kevin M. Lippman
Texas Bar No. 00784479
4000 Fountain Place
1445 Ross Avenue
Dallas, Texas 75202
Telephone: (214) 855-7553
Telecopier: (214) 978-4335
Email: klippman@munsch.com

- and -

BRAGAR WEXLER EAGEL & MORGENSTERN, P.C.
Lawrence P. Eagel
885 Third Avenue, Suite 3040
New York, New York 10022
Telephone: (212) 308-5858
Telecopier: (212) 486-0462
Email: eagel@bragarwexler.com

Attorneys for Aerotel, Ltd.

CERTIFICATE OF CONFERENCE

On the 8th day of September, 2005, I telephoned James Lee, Vinson & Elkins, L.L.P., counsel for the Debtors, to confer regarding the relief requested in the Motion. Mr. Lee advised me that the Debtors oppose the relief requested in the Motion.

By: /s/ Kevin M. Lippman
Kevin M. Lippman

CERTIFICATE OF SERVICE

The undersigned hereby certifies that, on this the 8th day of September, 2005, he caused a true and correct copy of this Motion to be served, by U.S. first class mail, postage prepaid on the parties listed on the attached service list.

By: /s/ Kevin M. Lippman
Kevin M. Lippman

DALLAS 1073311_3 7910.1