

Patent counterclaim not basis for removal

Suit vs. former executive remanded to state court

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A counterclaim seeking a declaration of patent non-infringement that a defendant filed in response to a plaintiff's state-law claims over a soured business relationship did not merit removing the case to federal court, a U.S. District Court judge has ruled.

The defendant, a former executive and co-owner of the plaintiff company, filed the counterclaim after the plaintiffs sued him and his new company in state court, alleging that he had acted in bad faith by "utilizing and exploiting" the plaintiffs' "intellectual property rights" before and after his departure.

In conjunction with the counterclaim, the defendants removed the case to federal court pursuant to the jurisdictional provisions of the America Invents Act, 28 U.S.C. §1454, which enable a litigant to remove a case to federal court based solely on a counterclaim that "arises under" U.S. patent law.

The plaintiffs contended that none of their state law claims sought relief for patent infringement and that their use of the term "intellectual property" in their pleadings referred to the theft of trade secrets and proprietary information, not to patents. Thus, the plaintiffs argued, the counterclaim did not "arise under" patent law and there was no basis for federal jurisdiction over the case.

Judge William G. Young agreed.

"At the motion hearing, the plaintiffs explained that the 'intellectual property' at issue is the information stored on [an] encrypted hard drive that [the defendant] took with him," Young wrote in ordering



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that the case be remanded back to state court. "Upon review, the court reluctantly gives more credence to the plaintiffs' arguments, recognizing that the term 'intellectual property' is at times ambiguously used in the complaint."

The 24-page decision is *Preston, et al. v. Nagel, et al.*, Lawyers Weekly No. 02-057-16. The full text of the ruling can be found at masslawyersweekly.com.

No 'one-way ticket'

Plaintiffs' co-counsel Joseph M. Cacace of Boston said the ruling should make clear that filing a patent-infringement counterclaim in what is simply a business dispute does not serve as a "one-way ticket" to federal court under the America Invents Act.

"The defendants still need to meet the other jurisdictional requirements to be in federal court, such as presenting an actual case or controversy under Article III of the Constitution," Cacace said. "The defendants failed to do so in this case because it just did not involve a live dispute about patent infringement, and Judge Young was not about to issue an advisory opinion."

Adding patent litigation to an already complex dispute not only would increase the complexity of the matter, Cacace said, but also increase the time it would take to progress, since patent cases have many procedural steps other cases are not required to follow.

"In our client's view, litigating the case in state court is a more efficient means of resolving what's actually in dispute, which is not patent infringement," he said.

Boston lawyer David A. Bunis, who practices complex business litigation, said Young's decision reinforces that federal District Court is a court of limited jurisdiction.

He pointed to Young's rejection of the defendants' argument that a claim regarding the failure to pay patent fees was enough on its own to establish "arising under" jurisdiction under patent law.

Considering that it was a close case, the ruling also reflects Young's confidence that the Superior Court has sufficient expertise in handling complex intellectual property cases under state law, Bunis added.

Cambridge patent litigator Craig R. Smith, meanwhile, said the decision might prove to have limited impact since the facts of the case

are so unique.

But Smith also said Young could have ruled either way on the plaintiffs' motion to remand back to Superior Court, and the plaintiffs could have avoided some of the confusion that occurred by drafting a clearer complaint that focused on trade secrets and other non-patent IP.

The defendants' lead counsel, Roberto M. Braceras of Goodwin Procter in Boston, declined to comment.

Relationship breakdown

Plaintiff John Preston and defendant Christopher Nagel were partners in multiple startup ventures that sought to exploit technology.

In June 1999, Preston and Nagel formed two companies, Electromagnetics Corp., or ELC, and Continuum Energy Technologies, or CET, as "affiliated companies" with overlapping management and ownership. Preston became vice president of ELC, and Nagel became its president. Meanwhile, Nagel assigned "intellectual property rights" to his inventions to ELC.

At the same time, the two men formed CET in order to research, develop and market technology covered by the patents titled to ELC. Along those lines, CET received a perpetual, royalty-free license to ELC's "most valuable intellectual property rights."

The setup enabled CET to exploit ELC's patents and other intellectual property while enabling ELC to obtain new patents that CET filed based on advancements on its intellectual property.

The licensing agreement contained noncompete and confidentiality provisions. In addition, Nagel agreed to various

confidentiality clauses with respect to ELC's and CET's proprietary information when signing employee and operating agreements with the two entities.

In the wake of unrelated third-party litigation, the relationship between Preston and Nagel deteriorated, and in December 2014, Nagel became involved with a new company, IDL Development. He resigned his position as a managing member of CET a month later, though he apparently remained a shareholder of ELC and CET.

In May 2015, Nagel allegedly proposed a complete restructuring of CET's "existing business entanglements" and the replacement of the ELC/CET license agreement with a much narrower technology/patent agreement. According to the plaintiffs, that was because he knew he needed CET's permission to carry out his proposed new venture and was planning to use ELC's licensed intellectual property to do so.

The plaintiffs also claimed that when Nagel left CET for IDL, he took documents and an encrypted hard drive containing data that were irreplaceable without his cooperation and hired CET's research team, rendering CET unable to continue to conduct experiments.

Additionally, Nagel apparently directed ELC to stop paying its patent fees, which allegedly rendered its license to CET worthless and freed him to do with the intellectual property as he pleased.

ELC, CET and Preston ultimately sued Nagel and IDL in Superior Court, alleging breach of fiduciary duty, breach of licensing agreements, conversion and violation of Chapter 93A.

Characterizing the case as a patent dispute, the defendants removed the case to U.S.

District Court and filed a counterclaim seeking a declaration that they had not infringed on any of the plaintiffs' patents.

The plaintiffs, disputing the defendants' assertion that any of their claims arose under patent law, moved to remand the case back to Superior Court.

No jurisdiction

Young rejected the defendants' arguments that three of the plaintiffs' claims arose under patent law.

Specifically, he was unconvinced that the plaintiffs' allegations that the defendants were exploiting their "intellectual property" rights and their statement in their complaint that ELC was serving as a "repository for patents" developed by CET turned the litigation into a patent case.

Young noted that the plaintiffs were alleging that Nagel raised funds for IDL, recruited CET researchers for IDL, removed sensitive data from CET premises, and attempted to interfere with ELC's corporate structure in a way that enabled him to direct ELC to stop protecting its patents through payment fees.

"These strands of allegations are seemingly distinct, leading the court to the conclusion that the defendants' only transgression with respect to patents alleged to have already taken place is the failure to pay patent fees," Young said.

Accordingly, the judge ordered that the case be remanded to Superior Court, concluding that "the defendants have not met their burden of proving that any of the ... counts ask for relief in any way related to the infringement of ELC's patents and, thus, that they 'arise under patent law.'" **MLW**



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