

Breach of Contract Claim Does Not Arise Under Patent Law

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The US Court of Appeals for the Federal Circuit reversed a district court decision that retained jurisdiction over a breach of contract action, finding that the action did not sufficiently implicate issues of patent law and instead was simply a state law contract case for past royalties. *Inspired Development Group, LLC and Mitchell Prine v. Inspired Products Group dba KidsEmbrace, LLC*, Case No. 18-1616 (Fed. Cir. Sept. 18, 2019) (Prost, CJ).

Mitchell Prine formed Inspired Development after developing children's car seat designs in the shape of cartoon and comic book characters. As part of the development, Prine obtained and assigned several patents to Inspired Development. Prine also formed and acted as CEO of a second company, KidsEmbrace, to sell the car seats. Inspired Development and KidsEmbrace entered into an exclusive patent licensing agreement that granted KidsEmbrace an exclusive license to practice the patents in exchange for royalties.

KidsEmbrace subsequently sought additional financing from a corporation named Boliari. As a condition of the investment, Inspired Development and KidsEmbrace executed a binding letter of agreement that required Inspired Development to transfer patent rights to KidsEmbrace in the event KidsEmbrace was acquired. In exchange, Inspired Development would receive a minimum royalty payment. After the deal was struck, Prine was removed as CEO and KidsEmbrace unilaterally terminated the exclusive patent licensing agreement.

Inspired Development filed suit against KidsEmbrace alleging breach of contract and other equitable state law claims. KidsEmbrace asserted counterclaims of breach of contract, fraud, negligent misrepresentation, restitution and breach of fiduciary duty. Both parties relied on diversity to establish subject matter jurisdiction. On summary judgment, Inspired Development lost its claim of breach of contract and equitable claims of unjust enrichment. Inspired Development appealed to the US Court of Appeals for the 11th Circuit.

The 11th Circuit spotted a potentially fatal problem: that diversity of citizenship might not exist. After closer examination, the parties admitted that they were not diverse and diversity jurisdiction did not apply. KidsEmbrace, however, attempted to anchor jurisdiction on a different basis, namely that federal jurisdiction existed because the case presented a federal question. The 11th Circuit remanded the subject matter question for the district court to consider in the first instance. The district court accepted KidsEmbrace's argument that the breach of contract and equitable claims arose under patent law. The case returned to the 11th Circuit for review of that decision, and on appeal, the

11th Circuit transferred the appeal to the Federal Circuit to answer whether federal subject matter jurisdiction existed.

The Federal Circuit noted that under the Supreme Court of the United States' 2013 decision in *Gunn v. Minton*, federal jurisdiction over a state law claim will lie if a federal issue is (1) necessarily raised, (2) actually disputed, (3) substantial and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress. Because the parties focused their dispute on the claim for unjust enrichment, the Court centered its analysis on that claim.

Starting with the first requirement of *Gunn*, the Federal Circuit found that a patent law issue was not raised by the unjust enrichment claim. Under Florida law, the elements for unjust enrichment are that the plaintiff conferred a benefit on the defendant who has knowledge thereof, the defendant voluntarily accepts and retains the benefit, and the circumstances are such that it would be inequitable for the defendant to retain the benefit without paying the plaintiff. The Court found that while it was possible that Inspired Development could succeed on its claim for unjust enrichment by showing patent infringement, it would also be possible for Inspired Development to succeed on its claim by showing that through the license conferred on KidsEmbrace, KidsEmbrace avoided litigation, acquired investment it may not have otherwise had, or succeeded in preventing competition for a certain length of time. The Court found that because Inspired Development did not have to demonstrate that KidsEmbrace actually practiced the patents, the question of infringement was not a necessary part of the claim.

Addressing the second *Gunn* requirement, the Court found that the issue of whether KidsEmbrace actually used the patents was disputed, because KidsEmbrace denied that it manufactured or sold products within the scope of the patent.

Turning to the third *Gunn* factor, the Federal Circuit stated that the touchstone of "substantiality" is whether allowing state courts to resolve the case would undermine the development of a uniform body of patent law. The Court found that there was no substantial issue of patent law because:

- Inspired Development could prevail on its unjust enrichment claim without showing that KidsEmbrace's products actually infringed.
- Any state court decision on a claim for unjust enrichment between the parties would not control numerous other cases.
- The government had no direct interest in a contract dispute between private parties.

Assessing the fourth *Gunn* factor, the Federal Circuit found that exercising federal jurisdiction would upset the balance of federal and state judicial responsibilities. The Court found that accepting KidsEmbrace's argument that any breach of contract claim or related equitable claim involving a patent license must "arise under" patent laws would sweep numerous state-law claims into federal court. The Court also noted that finding a federal question because the contract here implicated a run-of-the-mill question of infringement or invalidity would affect the wider balance between state and federal courts because a plaintiff could invoke federal jurisdiction by doing little more than pleading allegations involving an embedded infringement or invalidity analysis.

Accordingly, the Federal Circuit found that the district court lacked subject matter jurisdiction and thus vacated the district court's judgment and remanded for dismissal.

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