IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

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TYCO HEALTHCARE RETAIL GROUP, INC.
and PARAGON TRADE BRANDS, INC.,

OPINION AND ORDER

Plaintiffs,

03-C-0156-C

v.

KIMBERLY-CLARK CORPORATION,

Defendant.

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This is a civil action for monetary, declaratory and injunctive relief in which plaintiffs Tyco Healthcare Retail Group, Inc. and Paragon Trade Brands, Inc. allege that defendant Kimberly-Clark Corporation (1) attempted to create a monopoly by engaging in predatory and exclusionary conduct in violation of the Sherman Act, 15 U.S.C. § 2, by demanding royalties and attempting to enforce licensing agreements against non-infringing products sold by plaintiff Tyco Healthcare; (2) attempted to unreasonably restrain trade in violation of the Sherman Act, 15 U.S.C. § 1, by seeking to collect royalties on non-infringing products; (3) injured interstate competition in violation of the Sherman Act, 15 U.S.C. §§ 1 and 2; (4) engaged in patent misuse through its efforts to collect royalty fees for products not covered by its patents; (5) asserted wrongly that plaintiff Tyco Healthcare is a successor, assignee or is in combination with plaintiff Paragon; (6) attempted to enforce a license agreement that is void for failure of consideration because two patents had lapsed and the remaining patents are unenforceable; (7) breached the license agreement's express and implied warranties; (8) refused to excuse plaintiffs' performance of the license agreement because of frustration of purpose caused by the holding in Kimberly-Clark Corp. v. Tyco International, Inc., 4 Fed. Appx. 946, 2001 WL 170461 (Fed. Cir. Feb. 20, 2001) (unpublished).

Presently before the court is defendant's motion to dismiss for lack of subject matter jurisdiction or, in the alternative, to stay the proceedings pending completion of the arbitration ordered by the Circuit Court for Winnebago County, Wisconsin.

Because plaintiffs assert federal antitrust claims in their amended complaint, defendant's motion to dismiss for lack of subject matter jurisdiction will be denied. However, because only plaintiffs' affirmative claim of antitrust violations is not subject to arbitration and the arbitration panel's determination may make any further proceedings in this court unnecessary, I will stay the proceedings pending completion of the arbitration.

I have culled the following background facts from the amended complaint, briefs and record for the sole purpose of deciding the pending motion.

BACKGROUND FACTS

Plaintiff Tyco Healthcare Retail Group, Inc., plaintiff Paragon Trade Brands, Inc. and defendant Kimberly-Clark Corporation are competitors in the diaper and absorbent pants market.

In 1995, defendant filed a lawsuit against plaintiff Paragon for patent infringement in the United States District Court for the Northern District of Texas. In that lawsuit, defendant alleged that plaintiff Paragon had infringed its "Enloe patents." (The Enloe patents refer collectively to Patent No. 4,704,116, No. 4,846,823, No. 5,413,570, No. 5,415,644 and No. 5,599,338, which are directed to infant disposable diapers and absorbent pants with fluid pervious flaps.) In 1998, while the litigation was still pending, plaintiff Paragon filed for bankruptcy protection in the United States Bankruptcy Court for the Northern District of Georgia.

On March 15, 1999, plaintiff Paragon and defendant settled their Texas lawsuit by entering into a non-exclusive license agreement. The license agreement allowed plaintiff Paragon to use defendant's Enloe patents in diaper products sold in the United States and Canada. Pursuant to §§ 4.01 and 4.02 of the agreement, plaintiff Paragon was to pay defendant a percentage royalty based on net sales as well as a minimum annual royalty of $5 million. The minimum annual royalty was payable in quarterly installments of $1.25 million. Any percentage royalty paid counted toward the minimum royalty payment due.

As to arbitration, the March 1999 license agreement provided that:

> Any dispute between [defendant] and [plaintiff Paragon] as to whether or not a given Infant Disposable Diaper or Absorbent Pant is subject to payment of a percentage royalty under the terms of this Agreement or the amount of any royalty hereunder shall be subject to mandatory binding arbitration by a panel of three arbitrators . . . Any such arbitration shall be limited in scope to the question of whether or not a given Infant Disposable Diaper or Absorbent Pant is subject to payment of a percentage royalty under the terms of this Agreement (including the proper construction of the Valid Claim(s) of the Enloe Patent asserted to be infringed) or the required amount of such payment and shall not address any aspect or issue concerning the validity of any of the Enloe Patents, which validity shall be presumed.

In May 1999, two of the Enloe patents (No. 5,413,570 and 5,415,644) lapsed because of defendant's failure to pay the required maintenance fees.

In November 1999, in Kimberly-Clark v. Tyco International (US), Inc., No. 98-C-756-C (W.D. Wis. Nov. 3, 1999) (unpublished), this court held that Kendall Company's products did not infringe defendant's Enloe patents. Kendall Company was Tyco International's co-defendant in the lawsuit as well as plaintiff Tyco Healthcare's predecessor. In February 2001, the Court of Appeals for the Federal Circuit affirmed this court's holding in Kimberly-Clark Corp. v. Tyco International, Inc., 4 Fed. Appx. 946, 2001 WL 170461 (Fed. Cir. Feb. 20, 2001) (unpublished).

In April 2001, in light of the court of appeals' affirmation of this court's ruling that Kendall Company's products did not infringe the Enloe patents, plaintiff Paragon demanded that defendant arbitrate whether it could recover percentage royalties paid to defendant under the March 1999 license agreement. In November 2001, defendant and plaintiff Paragon restructured their March 1999 license agreement in order to avoid arbitration. In the November 2001 agreement, defendant and plaintiff Paragon agreed that (1) Paragon was not infringing the Enloe patents; (2) no percentage royalties would be due in the future; and (3) all other provisions in the March 1999 agreement would remain in effect, including the $5 million minimum annual royalty and increased minimum royalty provisions. The increased minimum royalty provision provided that the minimum royalty would increase if Paragon "combined" with any other entity selling infant disposable diapers. (The March 1999 agreement increased the amount of royalties "in the event of assignment hereunder to or any combination of [plaintiff Paragon] and an existing business which sells Infant Disposable Diapers." The March 1999 agreement provided further that it "shall be binding upon and inure to the benefit of the successors and assigns of all or substantially all of [plaintiff Paragon's] Infant Disposable Diaper business and the successors and assigns of all or substantially all of [plaintiff Paragon's] Absorbent Pants business.").

In January 2002, plaintiff Tyco Healthcare acquired plaintiff Paragon by purchasing 100% of its stock. Plaintiff Paragon continued to operate under its own corporate identity. Although plaintiff Paragon sought defendant's consent to assign the March 1999 and November 2001 license agreements to plaintiff Tyco Healthcare and defendant consented, no assignment materialized.

In May 2002, defendant asserted that plaintiff Tyco Healthcare, Tyco International Services AG and Tyco International (US) Inc. owed it the $5 million minimum annual royalty. (It is unclear which entity defendant requested payment from.) Defendant asserted further that it was entitled to an increased minimum royalty pursuant to Article IX of the March 1999 license agreement (as restructured by the November 2001 license agreement) based on the existing diaper sales of all three Tyco entities.

On May 30 and August 29, 2002, one of the Tyco entities (it is unclear which one) paid defendant the $1.25 million quarterly minimum royalty. (It is unclear whether a third royalty payment has been made.)

On September 19 and December 4, 2002, Tyco refused to pay defendant any further royalties under Article IX of the license agreement, claiming that defendant engaged in patent misuse by extending the license agreement to products that do not infringe the Enloe patents. (Again, it is unclear which Tyco entity or entities refused to pay defendant.)

On January 8, 2003, defendant wrote Tyco International and demanded arbitration regarding the royalties due under the license agreement. Defendant also informed Tyco International that it was selecting one of the three arbitrators pursuant to Article VI of the license agreement. Defendant did not make a demand for arbitration on plaintiff Paragon even though Article VI and XII of the license agreement required it to do so.

On February 20, 2003, all three Tyco entities rejected defendant's demand for arbitration, claiming that under Article VI of the March 1999 license agreement, arbitration is limited “to the question of whether or not a given Infant Disposable Diaper or Absorbent Pant is subject to payment of a percentage royalty under the terms of this Agreement.”

On March 14, 2003, defendant petitioned the Circuit Court for Winnebago County, Wisconsin, to compel Tyco International (US) Inc. and plaintiff Tyco Healthcare to arbitrate their dispute concerning royalty payments.

On April 2, 2003, Judge Hart-Key held that “Tyco” was a successor to plaintiff Paragon, but that the issue whether there had been an assignment or combination under the license agreement (and thus whether royalties were due) was not arbitrable. Defendant filed a motion to reconsider the ruling. On May 5, 2003, Judge Carver reversed Judge Hart-Key’s ruling and ordered arbitration to determine the amount of royalties due, ruling from the bench that whether there was a combination under the license agreement was a sub-issue of the parties’ royalty dispute rather than a condition precedent. (It is unclear why a different judge determined the motion to reconsider.) On June 3, 2003, Judge Carver issued a written opinion granting defendant’s petition to compel arbitration and ordered “Tyco International (US) Inc. and Tyco Healthcare Retail Group, Inc. and entities controlled by them (including Paragon Trade Brands, Inc.) to arbitrate with Kimberly-Clark Corporation the dispute described in Kimberly-Clark Corporation’s Demand for Arbitration (January 8, 2003).” See Second Aff. of Michael Modl, dkt. #14, Exh. E., at 2.

Defendant's demand for arbitration sought "an award of past-due royalties, plus pre-award and post-award interest, and an order which (a) fixes the new minimum royalty now payable by Tyco, and (b) compels Tyco to pay the royalties under the Agreement for the remainder of the period in which the Agreement is in effect." Aff. of Michael Modl, dkt. #5, at Exh. C. In addition, defendant's demand alleged that "Tyco," as an affiliate of plaintiff Paragon, became a successor to the license agreement and that a combination triggered an increase in the minimum royalty. Id.

On June 20, 2003, the arbitration panel determined that the proceedings would encompass defendant's claim of royalty payments due and any defense that plaintiffs might assert in *defense* of that claim (including patent misuse and antitrust) other than the defense concerning the validity of the Enloe patents. The panel held further that plaintiffs' *affirmative* antitrust claims would be excluded from the scope of the proceedings. The arbitration panel has scheduled a hearing for November 17-19, 2003.

OPINION

The parties originally disputed whether plaintiffs' complaint alleged a federal question that would give rise to subject matter jurisdiction in this court. (The parties concede that no diversity jurisdiction exists.) After defendant filed the present motion, plaintiffs amended their complaint as of right under Fed. R. Civ. P. 15(a), adding several allegations of antitrust violations pursuant to the Sherman Act, 15 U.S.C. §§ 1 and 2. Although defendant asserts that these new allegations are frivolous, it concedes nevertheless that plaintiffs have corrected any jurisdictional deficiencies that may have existed. See Dft.'s Reply, dkt. #13, at 2. This is correct. Because plaintiffs' amended complaint raises a federal question, defendant's motion to dismiss for lack of subject matter jurisdiction will be denied. Therefore, I turn to the question whether this case should be stayed pending the outcome of the arbitration ordered by the Circuit Court for Winnebago County.

Defendant argues that because the state court has determined that the issues raised in plaintiffs' complaint are arbitrable, the Rooker-Feldman doctrine forbids review of the state court's decision by this court. See Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923); District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983). Under the Rooker-Feldman doctrine, inferior federal courts (all federal courts other than the United States Supreme Court) lack jurisdiction to review state court decisions. Id. Review of such proceedings is limited to state courts and the United States Supreme Court. Id.; see also GASH Associates v. Village of Rosemont, 995 F.2d 726, 728 (7th Cir. 1993). The state court ordered the parties to arbitrate the issues in defendant's demand for arbitration, not the issues raised in plaintiffs' complaint in this lawsuit. Nevertheless, to the extent that the issues in defendant's demand for arbitration are included in plaintiffs' amended complaint, the Rooker-Feldman doctrine is applicable. Thus, because the state court determined that the parties must arbitrate their dispute concerning royalty payments, succession and combination and because plaintiffs alleged these issues in their amended complaint, the Rooker-Feldman doctrine bars this court from revisiting the state court's decision to compel arbitration as to these issues.

However, plaintiffs argue that their claims of antitrust violations and patent misuse are properly before the court because the state court "explicitly excluded" these issues from arbitration. However, the state court's colloquy as to the issues of antitrust and patent were in response to *hypothetical* questions. See Plts.' Resp., dkt. #8, at 21-22 (note court's use of word "suppose" during exchange). The patent and antitrust issues were not before the court. See Long v. Shorebank Development Corp., 182 F.3d 548, 555 (7th Cir. 1999) (Rooker-Feldman doctrine does not preclude federal court from considering "a federal claim alleging a prior injury that a state court failed to remedy"). Therefore, it is not correct to say that the state court "explicitly excluded" these claims from arbitration. The state court hypothesized that these issues would not be arbitrable, but it never made such a determination because they were not before the court.

Nevertheless, the Rooker-Feldman doctrine "applies not only to claims that were actually raised before the state court, but also to claims that are inextricably intertwined with state court determinations." Long, 182 F.3d at 554 (citing Feldman, 460 U.S. at 482 n.16). The state court determined that the parties' dispute as to the issues of royalty payments, succession and combination had to be arbitrated pursuant to the license agreement. After the state court made its determination, the arbitration panel determined that the scope of its proceedings will encompass plaintiffs' defense of antitrust violations, but not their affirmative claim of antitrust violations. This is logical. Defendant alleged that plaintiffs owe it royalty payments under the license agreements. In defense of that allegation, plaintiffs alleged that defendant's actions in procuring and enforcing the license agreements violate antitrust laws. Thus, plaintiffs' antitrust defense is inextricably intertwined with defendant's claim of non-payment of royalties. The same is true as to plaintiffs' patent misuse defense. Notwithstanding the state court's dicta as to the propriety of arbitrating the antitrust or patent misuse claims, the Rooker-Feldman doctrine applies to these defenses because they are inextricably intertwined with defendant's claim for royalties due.

This conclusion harmonizes nicely with the well-pleaded complaint rule, which provides that a federal law defense does not provide a basis for federal question jurisdiction. See Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 673-74 (1950) (holding that it would "distort the limited procedural purpose of the Declaratory Judgment Act" to allow federal jurisdiction on the basis of request for declaratory judgment that is actually anticipation of federal defense); Franchise Tax Bd. v. Construction Laborers Vacation Trust, 463 U.S. 1 (1983); see also Scheiber v. Dolby Laboratories, Inc., 293 F.3d 1014, 1016 (7th Cir. 2002) (holding that defense of patent misuse is irrelevant to determining whether federal question jurisdiction exists). In other words, just as asserting a federal defense does not give rise to federal question jurisdiction, asserting a defense that is not within an arbitration clause does not make an otherwise arbitrable claim no longer arbitrable. Allowing such a ploy would permit a party to evade arbitration by simply asserting a defense that falls outside the boundary of an arbitration clause.

A word is necessary regarding the distinction between patent misuse and patent validity. Plaintiffs argue vaguely that they have asserted "patent issues" and imply that these issues encompass a claim of patent invalidity. However, plaintiffs' amended complaint does not seek a declaration that defendant's patents are invalid. Rather, the only "patent issues" that alleged in plaintiffs' amended complaint concern patent misuse, not patent validity. See Am. Cpt., dkt. #7, Count IV, at 13 ("[defendant] has misused the Enloe Patents rendering the Enloe Patents unenforceable. . . . As a result of the unenforceability of the Enloe Patents, the License Agreement is void."). Patent validity and patent misuse are not the same creatures. See Critical-Vac Filtration Corp. v. Minuteman Intern., Inc., 233 F.3d 697, 703 (2d Cir. 2000) (discussing distinction between patent misuse and patent invalidity); see also Fromson v. Advance Offset Plate, Inc., 755 F.2d 1549, 1552 (Fed. Cir. 1985) (plaintiff asserting distinct claims of patent invalidity and patent misuse). In fact, the defense of patent misuse is closely related to antitrust. See 6 Chisum on Patents § 19.04[2] (2003) ("conduct which in some respects falls short of an antitrust violation may still constitute misuse").

Because only plaintiffs' affirmative claim of antitrust violations is not subject to arbitration and the arbitration panel's determination may make any further proceedings in this court unnecessary, I will stay the proceedings pending completion of the arbitration.

ORDER

IT IS ORDERED that

1. Defendant Kimberly-Clark Corporation's motion to dismiss for lack of subject matter jurisdiction is DENIED;

2. Defendant's alternative motion to stay the proceedings pending completion of the arbitration is GRANTED. Because the arbitration proceeding may resolve all of the issues among the parties and make any further proceedings in this court unnecessary, the clerk of court is directed to close the case administratively. In the event the arbitration does not resolve all of the issues, the case will be reopened immediately upon motion of any party and

will be set promptly for trial, with the parties retaining all rights they would have had had the case not been closed for administrative purposes.

Entered this 24th day of July, 2003.

BY THE COURT:

BARBARA B. CRABB
District Judge