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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

MEDTRONIC SOFAMOR DANEK, INC.,

Plaintiff,

vs. No. 01-2373 GV

GARY KARLIN MICHELSON, MD, and
KARLIN TECHNOLOGY, INC.,

Defendants.

ORDER GRANTING IN PART AND DENYING IN PART DANEK'S MOTION TO DISMISS CERTAIN COUNTERCLAIMS

Plaintiff Medtronic Sofamor Danek ("Danek"), a medical technology company, brings this suit to declare its intellectual property and contract rights under a license agreement entered into with Defendant Karlin Technology, Inc. ("KTI"), under a separate purchase agreement[1] entered into with Defendant Gary K. Michelson, MD, ("Michelson"), an inventor, and under an assignment and guarantee executed by Michelson. The license agreement concerns threaded implants for use in spinal surgical stabilization procedures and instruments and methods related to the surgical procedures. The purchase agreement concerns non-threaded implants for use in spinal surgical procedures and instruments and methods related to the procedures.

In its second amended complaint, Danek requests declaratory relief that, by virtue of the agreements, it does not infringe

[1] The license and purchase agreements will be referred to collectively as "the agreements."

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any patent of KTI or Michelson. Danek also seeks declaratory relief that the actions of KTI and Michelson in invoking the "best efforts" clauses of the agreements in an attempt to take back the subject technology are ineffective, null, and void. Danek requests injunctive relief to protect from others the intellectual property to which it believes it is entitled under the agreements and under the assignment and guarantee. In addition, Danek seeks damages and specific performance from KTI and Michelson based on their alleged breaches of the agreements and the assignment and guarantee. These damages sought by Danek include damages from Michelson on account of tortious interference with contract and damages from both Michelson and KTI resulting from intentional and/or negligent misrepresentation. Finally, Danek seeks declaratory relief that it is not engaged in any wrongful conduct with respect to KTI or Michelson, including breaches of contract; misappropriation or derivation of inventions and/or devices; misappropriation of confidential information or trade secrets; coercion; fraud; misrepresentation; unfair competition; or any unfair, dishonest, deceptive, destructive, fraudulent, or discriminatory practices.

Both defendants have filed counterclaims against Danek seeking damages, injunctive relief, and specific performance and declaratory relief. They allege claims of patent infringement, breach of contract, conversion, unjust enrichment, fraud, misappropriation of trade secrets, unfair competition, interference with contract, and violations of the Lanham, Sherman, and Clayton Acts. In addition, Michelson has filed a

third-party complaint against Danek seeking damages and injunctive and declaratory relief for breach of contract, fraud, and violations of the Lanham Act.

Currently before the court is Danek's November 28, 2001 Federal Rule of Civil Procedure 12(b)(6) motion to dismiss defendants' counterclaims claims alleging violations of the Lanham Act (nineteenth counterclaim), unfair competition (seventeenth counterclaim), conversion (fifth and ninth counterclaims), tortious interference with contract (eighteenth counterclaim), and unjust enrichment (sixth and tenth counterclaims).

In considering a Rule 12(b)(6) motion to dismiss, the court is limited to examining whether the complaint sets forth allegations sufficient to make out the elements of a cause of action. Windsor v. The Tennessean, 719 F.2d 155, 158 (6th Cir. 1983). A complaint should not be dismissed under Rule 12(b)(6) "unless it appears beyond doubt that the [p]laintiff can prove no set of facts in support of his claim which would entitle him to relief." Lillard v. Shelby County Bd. of Educ., 76 F.3d 716, 724 (6th Cir. 1996) (quoting Conley v. Gibson, 355 U.S. 41, 45-46 (1957)). In reviewing the plaintiff's complaint on a motion to dismiss, the court's duty is to "construe the complaint liberally in the plaintiff's favor and accept as true all factual allegations and permissible inferences therein." Conley, 355 U.S. at 45-46.

As a preliminary matter, the court considers Danek's motion to dismiss with respect to defendants' counterclaims for

violations of the Lanham Act (nineteenth counterclaim) and for unjust enrichment (sixth and tenth counterclaims). These counterclaims are identical to Michelson's Third-Party complaint claims for violations of the Lanham Act and unjust enrichment, which the court considered in an earlier order. (Sept. 5, 2002 Order Denying Danek's Mtn. to Dismiss Certain Third-Party Claims.) The parties present no new arguments with respect to these counterclaims. Thus, for the same reasons stated in the court's September 5, 2002 order, Danek's motion to dismiss is denied with respect to defendants' counterclaims for violations of the Lanham Act and unjust enrichment.

The court now turns to the remaining counterclaims. First, it considers whether defendants have stated a claim for unfair competition for which relief can be granted. In their seventeenth counterclaim, defendants allege that Danek's wrongful acts and conduct constitute unfair and unlawful competition and that this unfair competition threatens to and will cause great and irreparable injury to defendants in that such conduct will result in the loss of substantial opportunities for exploiting defendants' Threaded Spinal Implant Technology, Non-Threaded Spinal Implant Technology, and new inventions. (Counterclaim ¶¶ 147-49.)

In both its motion to dismiss and reply memorandum in support of the motion, Danek argues that defendants have failed

to plead the necessary elements to assert a claim for unfair competition under Tennessee law.

Tennessee law on unfair competition governs in this case.[2] Under Tennessee law, the tort of unfair competition, "in its most common form [i.e. trademark infringement cases] . . . requires a showing" that:

> (1) [T]he defendant engaged in conduct which "passed off" its organization or services as that of the plaintiff; (2) in engaging in such conduct, the defendant acted with an intent to deceive the public as to the source of services offered or authority of its organization; and (3) the public was actually confused or deceived as to the source of the services offered or the authority of its organization.

Sovereign Order of St. John v. Grady, 119 F.3d 1236, 1243 (6th Cir. 1997) (cited in Dade Int'l, Inc., v. Iverson, 9 F. Supp. 2d 858, 861 (M.D. Tenn. 1998)).

The Tennessee Court of Appeals, however, has recognized that it is sometimes appropriate to extend the tort of unfair competition beyond the context of trademark infringement. In B & L Corp., v. Thomas & Thorngren, Inc., 917 S.W.2d 674, 681 (Tenn. Ct. App. 1995), the court noted that "[u]nfair competition is a generic name for several related torts involving improper interference with business prospects." In reaching this conclusion, the B & L court relied in part on a treatise, Prosser

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[2] The agreements entered into by the parties explicitly provide that agreements shall be "governed by and construed under the laws of the State of Tennessee, without regard to the laws of any other state, jurisdiction or country." License Agreement at § 13.1; Purchase Agreement at § 12.1.

and Keeton on the Law of Torts § (5th ed. 1984). A federal district court in Dade International, Inc. v. Iverson, 9 F. Supp. 2d at 862, expounded upon the B & L court's holding by noting that Prosser and Keeton describes the tort of unfair competition as arising "'when the defendant engages in any conduct that amounts to a recognized tort and when that tort deprives the plaintiff of customers or other prospects.'" Id. (quoting Prosser and Keeton § 130). The Dade court also cited the treatise for the proposition that "'[u]nfair competition . . . does not describe a single course of conduct or a tort with a specific number of elements; it instead describes a general category into which a number of new torts may be placed when recognized by the courts.'" Id. As a result of its analysis of Prosser and Keeton, the Dade court concluded that "the tort of unfair competition is simply a remedy for economic loss that is incurred from an underlying violation of a tort or a breach of contract." Id.

Now turning to the instant case, because it does not concern trademark infringement, defendants' failure to allege facts pertaining to the three elements noted above is not fatal to their claim. In this case, defendants allege multiple underlying torts and breaches of contract. (Counterclaim ¶¶ 50-55, 68-72, 84-94, 106-11, & 140-46 (breach of contract); ¶¶ 73-77 & 95-99 (conversion); ¶¶ 112-18 (fraud); ¶¶ 130-39 (misappropriation of

trade secrets); and ¶¶ 150-54 (tortious interference with contract).) In addition, defendants assert that Danek's acts of unfair competition caused irreparable injury to them and resulted in the loss of substantial opportunities for exploiting their technology. These facts are sufficient to allege economic loss that is incurred from an underlying violation of a tort or a breach of contract. Accordingly, Danek's motion to dismiss is denied with respect to defendants' unfair competition claim.

The court now turns to whether defendants have stated a claim for conversion. In their fifth and ninth counterclaims, defendants allege that Danek has exercised dominion over defendants' intellectual property by refusing to restore the property despite defendants' demands that Danek return it. (Counterclaim ¶¶ 71, 93.) Further, defendants assert that Danek's appropriation is for "its own private use, benefit, and enjoyment, in disregard of [defendants'] rights." Id. ¶¶ 75,97.

Danek argues that defendants have failed to properly allege a conversion because, under the parties' agreements, defendants had only a potential right to repurchase the intellectual property, not a valid interest in the intellectual property sufficient to support a claim for conversion under Tennessee law.

Pursuant to Tennessee law, conversion is the "appropriation of [something] to the party's own use and benefit, by [] exercising dominion over it, in defiance of plaintiff's right."

Mammoth Cave Prod. Credit Ass'n v. Oldham, 569 S.W.2d 833, 836 (Tenn. Ct. App. 1977). In addition, a plaintiff must show a right to possession of the item converted at the time of its conversion. AHCI, Inc. v. Short, 878 S.W.2d 112, 115 (Tenn. Ct. App. 1993) ("'It seems true ordinarily that conversion can be maintained only if the plaintiff can show possession or a right to immediate possession of the item covered at the time of the alleged conversion.'") (quoting Mammoth Cave, 569 S.W.2d at 836-37).

In their counterclaim, defendants allege that the License Agreement contains a "best efforts" provision. They further allege that this provision "requires [Danek] to use its best efforts 'to obtain regulatory approval and to actively promote the sale of [defendants' technology],' and [that,] if [Danek] makes a business decision not to use its best efforts, [defendants are] entitled to terminate [Danek's] license or buy back from [Danek] the licensed or assigned rights." (Counterclaim ¶ 22(a).) Defendants assert that the Purchase Agreement contains a similar clause. Id. ¶ 23(a). According to defendants, Danek "has effectively made a business decision to do exactly the opposite" of using its best efforts. Id. ¶ 35. Specifically, defendants assert that Danek "has developed and marketed [technology] that compete[s] with [defendants' technology] licensed under the License Agreement." Id. In

addition, defendants assert that Danek has effectively made a business decision not to use its best efforts to promote defendants' technology by failing to take any steps to commercialize defendants' technology outside the United States and by failing to initiate a single Investigational Devices Exemption, a testing procedure that is the first step in obtaining U.S. Food & Drug Administration approval for certain types of medical devices. Id. ¶ 36. Instead, according to defendants', Danek has been actively undermining the sales of defendants' technology by marketing and promoting its own competing products that are older and often higher-priced, id., and, thus, Danek's appropriation of defendants' technology is for "its own private use, benefit, and enjoyment, in disregard of [defendants'] rights," id. ¶¶ 75,97.

Although under the agreements defendants may have only a potential interest in buying back their technology, they assert that the circumstances which would allow them to do so have already occurred and that, despite their demands for the return of the technology, Danek has refused. The court finds that these allegations are sufficient to defeat Danek's Rule 12(b)(6) motion with respect to defendants' claim for conversion.

Finally the court considers whether defendants have stated a claim for tortious interference with contract. In their eighteenth counterclaim, defendants allege that Danek, if it was

not a party to the Three-Party Agreement[3] through its subsidiary Sofamor Danek Holdings ("Holdings"), was aware of and "purposefully and intentionally induced Holdings to breach the Three-Party Agreement." (Counterclaim ¶ 152.)

Danek argues that Danek cannot be liable for inducing Holdings to breach the Three-Party Agreement because Holdings is Medtronic's wholly-owned subsidiary, and, therefore, defendants' allegations are insufficient to overcome the general rule that a parent company is privileged to interfere with the contractual relations of a wholly-owned subsidiary and cannot be liable for tortiously interfering with its wholly-owned subsidiary's contracts.

The elements for tortious interference with contract are a legal contract, the wrongdoer's knowledge of the contract, an intent to induce breach, malice, breach, proximate cause between the malicious act and the breach, and damages as a result. Oak Ridge Precision Industries, Inc. v. First Tennessee Bank Nat'l Ass'n, 835 S.W.2d 25, 29 (Tenn. Ct. App. 1992) (citing Campbell v. Matlock, 749 S.W.2d 748 (Tenn. App. 1987). The cause of action has now been codified and may not be enforced except upon a "clear showing". Tenn. Code Ann. § 47-50-109.

With respect to wholly-owned subsidiaries, the Tennessee

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[3] Defendants, a company called Holdings (Danke's wholly-owned subisdiary), and Wright Medical Technology, Inc., a third party, were all parties to the Three-Party Agreement.

Supreme Court held in Waste Conversion Systems, Inc. v. Greenstone Industries, Inc., 33 S.W.3d 779, 780 (Tenn. 2000), that a parent corporation has a privilege pursuant to which it can cause a wholly-owned subsidiary to breach a contract without becoming liable for tortiously interfering with a contractual relationship. Id. However, this privilege is not absolute and may be lost if the parent company acts contrary to the subsidiary's economic interests or if the parent corporation employs wrongful means in such situations. Id. The Tennessee Supreme Court adopted holdings from Paglin v. Saztec Int'l Inc., 834 F. Supp. 1184, 1196 (W.D. Mo. 1993), and Boulevard Associates v. Sovereign Hotels, Inc., 72 F.3d 1029, 1037 (2d Cir. 1995), to define the phrase "wrongful means." The Paglin court defined wrongful means as follows: "In the context of interference with contractual relations, 'wrongful means' is defined to include acts which are wrongful in and of themselves, such as 'misrepresentations of facts, threats, violence, defamation, trespass, restraint of trade, or any other wrongful act recognized by stature or common law.'" Paglin, 834 F. Supp. at 1196 (cited by Waste Conversion, 33 S.W.3d at 784). The Boulevard court characterized the phrase in a narrow manner to include "fraud, misrepresentation, intimidation or molestation." Boulevard, 72 F.3d at 1037. The burden of pleading and proving that the defendant corporation acted with wrongful means in

causing its wholly-owned subsidiary to breach a contract is on the plaintiff. Waste Conversion, 33 S.W.3d at 784.

In the instant case, the court finds that defendants have sufficiently pled the existence of an enforceable contract, Danek's awareness of the contract, Danek's intent to induce with malice, breach, causation, and damages. Defendants' pleadings with respect to these elements are, in relevant part, as follows:

> 151. The Three-Party Agreement is an enforceable contract between Dr. Michelson and Holdings. At all relevant times [Danek] was aware of the terms of this contract.
>
> 152. . . . [Danek] . . . knew of the existence of and purposefully and intentionally induced Holdings to breach the Three-Party Agreement.
>
> 153. [Danek's] interference was improper and unjustified.
>
> 154. As a direct and proximate result of [Danek's] interference, Dr. Michelson has sustained damages in an amount to be proven at trial, but in no even less than $75,000.

(Counterclaim ¶¶ 151-54.)

The dispute between the parties with respect to the tortious interference claim, however, centers around whether defendants can overcome the privilege pursuant to which a parent corporation can cause a wholly-owned subsidiary to breach a contract without becoming liable for tortiously interfering with a contractual relationship. Because defendants do not allege that Danek acted contrary to its subsidiary's economic interests, the only other way to overcome the privilege is by pleading that the parent

corporation employed wrongful means in inducing its subsidiary to breach the contract. Defendants fail to plead any wrongful means employed by Danek in inducing Holding to breach the Three-Party Agreement. Defendants' assertion that Danek's interference was "improper and unjustified" (Counterclaim ¶ 153) is insufficient to overcome the well-established privilege that a parent corporation is not liable for inducing a wholly-owned subsidiary to breach a contract. Accordingly, Danek's motion to dismiss is granted with respect to defendant's counterclaim for tortious interference.

For the foregoing reasons, the court denies Danek's motion to dismiss with respect to defendants' Lanham Act, unjust enrichment, unfair competition and conversion counterclaims and grants it with respect to defendants' tortious interference counterclaim.

IT IS SO ORDERED.

Julia Smith Gibbons

JULIA SMITH GIBBONS
UNITED STATES CIRCUIT JUDGE
Sitting by Designation

September 9, 2002
DATE

UNITED STATES DISTRICT COURT - WESTERN DISTRICT OF TENNESSEE

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