

MEDICAL SPECIALTIES, INC.

Plaintiff,

v.

C. STEVEN YATES,

Defendant.

COMPLAINT

For its complaint in this action, Plaintiff Medical Specialties, Inc. (“Medical Specialties”) alleges as follows:

1. This is an action for declaratory judgment of where there is an actual case or controversy relating to whether Medical Specialties has any obligation to pay additional royalties to Defendant C. Steven Yates (“Defendant”) based upon the sale of certain products allegedly covered by now-expired U.S. Patent No. 5,067,486. As set forth below, Medical Specialties is a citizen of North Carolina, Defendant is a citizen of Georgia, and the amount in controversy exceeds the sum or value of \$75,000, exclusive of interest and costs. Further, a determination of claim construction and patent infringement is a necessary element of at least one of Medical Specialties’ claims for declaratory judgment. Accordingly, this Court has jurisdiction over this declaratory judgment action pursuant to 28 U.S.C. §§ 1332, 1338, 1367, and 2201.

VENUE

2. Venue lies in this district pursuant to 28 U.S.C. § 1391(a), (b) because a substantial part of the events giving rise to the claims herein occurred in North Carolina and within this judicial district.

THE PARTIES

3. Plaintiff Medical Specialties, Inc. is a corporation organized and existing under the laws of North Carolina with its corporate headquarters in Charlotte, North Carolina. Medical Specialties designs, manufactures, and sells orthopedic and sports medicine related products. Medical Specialties markets its products in North Carolina and other states.

4. Defendant C. Steven Yates is a citizen and resident of Georgia currently residing at 115 Vermont Court, Brunswick, Georgia 31525.

GENERAL ALLEGATIONS

The Development of the ASO Product and the ASO Patent

5. In early 1989, Medical Specialties entered into an arrangement with Defendant regarding the development, evaluation, and promotion of a product known as the Ankle Stabilizing Orthosis (“ASO”). The initial terms of the arrangement are memorialized in a March 27, 1989 Letter to Defendant. *See* Ex. A, Complaint, Attach 1. A patent application was filed on March 28, 1990, and a patent with claims covering the ASO product issued on November 26, 1991, U.S. Patent No. 5,067,486 (“the ‘486 Patent”). Ex. B.

6. After Medical Specialties began manufacturing and selling the ASO in 1989, Medical Specialties paid Defendant based upon the volume of sales of the ASO in accordance with the parties’ agreement. The payments to Defendant were shown as royalty payments on Defendant’s Internal Revenue Service (“IRS”) Form 1099.

Prior Litigation between Medical Specialties and Defendant

7. In 1995, disputes arose regarding the sufficiency of Defendant's promotional services relating to the ASO and whether Defendant was due royalty payments based upon the sales of the ASO and a product known as the ASO Axis. As a result of Defendant's alleged unsatisfactory services, Medical Specialties terminated Defendant's royalty payments as to sales of the patented ASO product. Defendant filed a civil action against Medical Specialties in the Superior Court of Forsyth County, Case No. 95-CVS-2773, alleging that Medical Specialties had breached the terms of the parties' agreement by ceasing royalty payments based upon sales of the ASO and by failing to provide him with royalty payments based upon sales of the ASO Axis.

8. On February 6, 1996, the parties entered into a Settlement Agreement that resolved the disputes underlying the Superior Court Action. *See* Ex. A, Attach 2. Pursuant to Sections 2 through 6 of the Agreement, Defendant agreed to perform certain services related to the ASO product. Under Section 7(b) of the Agreement, Medical Specialties agreed to pay Defendant certain specified royalty payments "as long as Medical Specialties and/or their assigns sells ASO and ASO Axis or similar items sold by Medical Specialties using the ASO patent number 5,607,486." Section 13 of the parties' Settlement Agreement, *inter alia*, provides that the Settlement Agreement "is the full and complete understanding of the Parties with respect to all matters set forth herein." *Id.*

Defendant Assigns all Rights in the '486 Patent

9. On October 19, 1999, Defendant executed an Assignment transferring all rights that he may have had in the '486 patent to Medical Specialties. Ex. C. To the extent Defendant is an inventor with regard to the '486 patent, the failure to name Defendant as an inventor occurred without any deceptive intent.

Characterization of Payments under the Agreement as Royalties

10. As set forth above at Paragraph 6, as early as 1990, Defendant was issued an IRS 1099 Form characterizing the payments to Defendant based upon the sales volume of the ASO as royalty payments.

11. For the 1999 tax year, Defendant requested that Medical Specialties issue a corrected Form 1099 characterizing payments under the Settlement Agreement as royalties based upon the sales volume of the respective patented products. The characterization of payments under the Settlement Agreement as royalties based upon the sales volume of patented products has continued through the current tax year.

The Expiration of the '486 Patent and the Current Litigation between the Parties

12. The '486 patent expired on March 28, 2010. Medical Specialties informed Defendant that pursuant to the parties' Settlement Agreement, and as a matter of federal patent law, Medical Specialties has no obligation to make continued royalty payments based upon the sales volume of any products previously covered by the now-expired '486 patent.

13. No product can use the '486 patent subsequent to its date of expiration because once a patent expires, it falls into the public domain.

14. During the term of the exclusionary right granted under the Patent Act, Defendant received substantial benefits pursuant to his negotiated, contractual right to receive royalty payments based upon the sales of patented products using the '486 patent.

15. The '486 patent entered the public domain on March 28, 2010. Because the '486 patent has entered the public domain, no contract can properly demand royalty payments based upon the sale of products that were formerly covered by the patent as a matter of federal patent law.

16. Medical Specialties has performed all of its obligations to Defendant as to the parties' Settlement Agreement.

17. Defendant initiated a civil action against Medical Specialties on December 6, 2010, in the North Carolina General Court of Justice, Superior Court Division, Mecklenburg County, Case No. 10-CVS-24536. *See* Ex. A. Defendant's Complaint alleges two claims for relief based upon the alleged breach of the Agreement by Medical Specialties to pay Defendant royalties based upon the sale of certain products allegedly covered by the '486 patent.

18. Defendant submitted a Notice of Designation declaring the Superior Court Case a Mandatory Complex Business Case under N.C. Gen. Stat. § 7A-45.4. Ex. D. Defendant's Notice of Designation states: "the interpretation and application of the terms of the contract will require consideration of certain aspects of federal patent law including, but not limited to, determining whether particular devices manufactured and sold by Defendant are within the scope of the claims of U.S. Patent No. 5,067,486." *Id.*

19. Defendant's first claim for relief alleges that Medical Specialties has breached the parties' Settlement Agreement by refusing to pay royalties due and owing based upon the sales of certain "Covered Devices." Ex. A at ¶27. "Covered Devices" are defined in the Complaint at Paragraph 12(a). In Paragraph 12(a), Defendant states Medical Specialties agreed to pay royalties "on any other embodiment of the [ASO] invention that used the '486 patent that it thereafter added to its product line (hereinafter 'the Covered Devices')." *Id.* ¶12. Defendant contends that "Covered Devices" are "including but not limited to the original ASO, the ASO Flex Hinge, the ASO Speed Lacer, the ASO Universal, and the ASO W/Stays[.]" *Id.* ¶24.

20. Defendant's second claim for relief relates to sales of a product known as the ASO EVO that was introduced by Medical Specialties in 2008. Defendant contends that the

ASO EVO is a “Covered Device” as defined at Paragraph 12(a) of the Complaint. *Id.* ¶33.

Defendant contends that the ASO EVO is an embodiment of the invention of the ‘486 patent, and that Medical Specialties has breached the parties’ Settlement Agreement by failing to pay royalties based upon sales of the ASO EVO.

21. Defendant seeks monetary damages and other relief against Medical Specialties in connection with its claims. Notwithstanding the amount of disputed future royalty payments, the disputed royalty payments that have accrued to date exceed \$75,000.

COUNT I
(DECLARATORY JUDGMENT)

22. Paragraphs 1 through 21 are incorporated by reference as if stated fully herein.

23. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that Medical Specialties has not breached the February 6, 1996 Settlement Agreement.

24. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that Medical Specialties has not breached the February 6, 1996 Settlement Agreement based upon the sales of allegedly Covered Devices including, but not limited to, the original ASO, the ASO Flex Hinge, the ASO Speed Lacer, the ASO Universal, and the ASO W/Stays.

25. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that the February 6, 1996 Settlement Agreement or portions of the Agreement that, *inter alia*, require Medical Specialties to make continued royalty payments to Defendant after expiration of the ‘486 patent are invalid, unenforceable and/or void.

26. An actual and judicable case or controversy exists between Medical Specialties and Defendant regarding whether Medical Specialties has breached the Settlement Agreement

based upon the sales of allegedly Covered Devices including, but not limited to, the original ASO, the ASO Flex Hinge, the ASO Speed Lacer, the ASO Universal, and the ASO W/Stays and whether the Settlement Agreement or portions of the Agreement are invalid, unenforceable and/or void.

27. Medical Specialties has no adequate remedy at law.

COUNT II
(DECLARATORY JUDGMENT)

28. Paragraphs 1 through 21 are incorporated by reference as if stated fully herein.

29. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that Medical Specialties has not breached the February 6, 1996 Settlement Agreement.

30. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that Medical Specialties' ASO EVO product does not infringe the '486 patent.

31. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that Medical Specialties has not breached the February 6, 1996 Settlement Agreement based upon sales of the ASO EVO.

32. Medical Specialties requests entry of a declaratory judgment, pursuant to 28 U.S.C. § 2201, that the February 6, 1996 Settlement Agreement or portions of the Agreement that, *inter alia*, require Medical Specialties to make continued royalty payments to Defendant after expiration of the '486 patent are invalid, unenforceable and/or void.

33. An actual and judicable case or controversy exists between Medical Specialties and Defendant regarding whether the ASO EVO product infringes the '486 patent, whether Medical Specialties has breached the Settlement Agreement based upon sales of the ASO EVO

product, and whether the Settlement Agreement or portions of the Agreement are invalid, unenforceable and/or void.

34. Medical Specialties has no adequate remedy at law.

PRAYER FOR RELIEF

WHEREFORE, Medical Specialties, Inc. respectfully requests that this Court enter a judgment or decree against Defendant:

(a) Declaring that Medical Specialties has not breached the February 6, 1996 Settlement Agreement;

(b) Declaring that the February 6, 1996 Settlement Agreement or portions of the Agreement that, *inter alia*, require Medical Specialties to make continued royalty payments to Defendant after expiration of the '486 patent are invalid, unenforceable and/or void;

(c) Declaring that Medical Specialties has not breached the February 6, 1996 Settlement Agreement based upon sales of allegedly Covered Devices including, but not limited to, the original ASO, the ASO Flex Hinge, the ASO Speed Lacer, the ASO Universal, and the ASO W/Stays;

(d) Declaring that Medical Specialties' ASO EVO product does not infringe the '486 patent;

(e) Declaring that Medical Specialties has not breached the February 6, 1996 Settlement Agreement based upon the sales of the ASO EVO;

(f) Awarding Medical Specialties the costs of this action against Defendant; and

(g) Granting Medical Specialties such additional and further relief as this Court deems just and proper.

DEMAND FOR JURY TRIAL

Plaintiff Medical Specialties, Inc. demands a trial by jury on all issues triable to a jury in this case as a matter of right.

Respectfully submitted this 5th day of January, 2011.

s/John P. Higgins

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