

High Court Nike Ruling Lets IP Owners Skirt Invalidity Claims

By **Ryan Davis**

Law360, New York (January 09, 2013, 9:15 PM ET) -- Patent and trademark owners who want to foreclose challenges to the validity of their intellectual property when dropping infringement suits have clear guidance from the U.S. Supreme Court on how to do so after a decision Wednesday that barred a challenge to a Nike Inc. trademark, attorneys said.

The justices ruled that a covenant not to sue that Nike had given rival shoe-maker Already LLC eliminated any future disputes between the companies and prevented courts from considering Already's claim that Nike's mark was invalid.

The dispute began in 2009, when Nike accused Already of infringing a trademark on its Air Force 1 sneakers. After Already struck back with claims that its mark was invalid, Nike decided to drop the suit and made an agreement not to sue its competitor for infringement. Already, however, fought to maintain its challenge to Nike's allegedly bogus mark.

The ruling emphasizes that IP validity challenges asserted in litigation are moot if the owner crafts a broad covenant not to sue, according to Philip Graves of Snell & Wilmer LLP — which means future litigants can use Nike's deal as a road map.

"I guarantee you that IP litigators will be looking at the specific scope of the terms used in this case and will be modeling covenants not to sue for clients on the one Nike proffered here," he said.

Nike's covenant is unconditional and irrevocable, and it applies to all of Already's current shoes and "any colorable imitations thereof." As a result, the high court ruled there was no chance a dispute could ever arise between the parties. Without any controversy, Already lacked standing to challenge the validity of Nike's mark, it concluded.

"The takeaway for practitioners is that while the court didn't say these are the elements that are required for a covenant not to sue, this is a standard you can look to when advising clients in similar situations," said Jedediah Wakefield of Fenwick & West LLP.

Already maintained that because its business was threatened by the continued existence of Nike's trademark, it should be allowed to challenge the mark's validity, despite the deal not to sue. The Supreme Court ruled that Article III of the U.S. Constitution clearly bars litigation when there is no live controversy between the parties.

Already essentially argued that "no possible covenant not to sue, no matter how broad, could eliminate the competitive effect of IP assets," Graves said. "The court soundly rejected that argument."

Already's position would have significantly expanded the scope of subject matter jurisdiction for declaratory judgment actions, he said, allowing for suits challenging the validity of IP in almost any circumstances. So the court's rejection of it sets important limits.

"If it had gone the other way and the court had adopted Already's theory, then we'd see literally a flood of litigation by companies trying to invalidate competitors' IP, based only on the fact that they are in the same field," said Donald Falk of Mayer Brown LLP. "That's not what Article III allows."

It is relatively rare for IP owners to voluntarily drop infringement suits they filed by executing covenants not to sue, though it is more common in patent cases than in trademark ones, attorneys said. The Nike ruling will likely apply in both contexts, allowing plaintiffs to drop suits without leaving their IP vulnerable to invalidity claims.

Already contended that Nike knew its lawsuit was weak and executed the covenant not to sue only after Already had mounted an unexpectedly vigorous case contending the mark was invalid. Nike claimed it had ended the suit only because the allegedly infringing shoes were no longer being sold, so the expense of continued litigation was not warranted.

While the Supreme Court gave IP owners a way to evade validity challenges when dropping suits, the ruling makes clear that the mere existence of a covenant not to sue does not by itself let plaintiffs off the hook, said Uli Widmaier of Pattishall McAuliffe Newbury Hilliard & Geraldson LLP.

That position is particularly evident in a concurrence written by Justice Anthony Kennedy, which suggests courts must ensure there is nothing about the covenant or the relationship between the parties that could give the defendant standing to challenge the validity of a mark, Widmaier said.

Justice Kennedy wrote that the trademark owner must show the covenant will not disrupt the defendant's business, such as by forcing it to expose future business plans, in order "to ensure that covenants are not automatic mechanisms for trademark holders to use courts to intimidate competitors."

"It's written to underscore that the covenant should not be taken as carte blanche," Widmaier said. "Trademark attorneys can't go to clients and say they can use this covenant tactic with impunity."

In most situations, a covenant not to sue that resembles Nike's would rule out invalidity counterclaims, according to Robert Kenney of Birch Stewart Kolasch Birch LLP. So IP owners must be sure they want to completely surrender any right to sue in the future and that the covenant's language reflects that.

"The key to this whole thing is that the covenant has to be properly worded and it has to be broad enough to cover any scenario you can envision where the plaintiff can sue the defendant," Kenney said.

Plaintiffs, he noted, must ask the question: "How far are you willing to go?"

For instance, had Nike's covenant not covered imitations of Already's existing products, Kenney said, the outcome of the case might have been different, because Already's argument that it might be sued in the future over new products would have been stronger.

Another concern for a plaintiff thinking about dropping an infringement suit is that covenants not to sue can have negative consequences for IP rights, Graves said.

For instance, widespread licensing of a trademark can weaken it to the point where it might be canceled, and a covenant not to sue can reduce the amount of damages available in patent litigation to a reasonable royalty, rather than lost profits.

"These covenants not to sue are not cost-free, which can stand as a limiting factor," Graves said. "That's something companies need to take into consideration when deciding whether to issue them."

For companies that do want to execute covenants not to sue using the Nike model, the Supreme Court's ruling "puts the highest level of endorsement on this particular contract language," while making clear that covenants must be extremely broad, Falk said.

"It underscores that this is not an easy out for companies concerned about their litigation position," he said. "You can't just walk away from the dispute; you have to deprive the other party of constitutional standing to pursue its claim."

--Editing by Kat Laskowski and Jeremy Barker.

All Content © 2003-2013, Portfolio Media, Inc.