Just Moot It: Supreme Court in *Already v. Nike* Clarifies When a Covenant Not to Sue Can Kill a Declaratory Judgment Case

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In 2007, the Supreme Court in *MedImmune v. Genentech* broadened the scope of declaratory judgment jurisdiction, making it easier for parties fearing IP claims to bring defensive lawsuits. Last week, the Court made it easier for IP owners to end them.

In *Already, LLC, dba Yums, v. Nike Inc.,* 586 U.S. ___; No. 11-982, 2013 WL 85300 (January 9, 2013), a trade dress case involving an athletic shoe design, the Court issued a unanimous decision clarifying the applicable legal standard for dismissing a case as moot where the defendant has voluntarily ceased the alleged wrongful behavior. The case started when Nike sued Yums for infringing its trade dress in its Air Force 1 shoe. After Yums filed a counterclaim to invalidate Nike's trade dress registration, Nike decided it wanted out. It dismissed its claims, and provided Yums a covenant not to sue it in the future. Nike then moved to dismiss the case, arguing that there was no longer any "case or controversy," and thus, no subject matter jurisdiction.

In affirming dismissal of a counterclaim for declaratory judgment, the Supreme Court found that a broad covenant not to sue can render a case moot, removing Article III standing. The Court clarified that such cases are analyzed under the "voluntary cessation" doctrine, and that a defendant hoping to rely on such tactic will bear a heavy burden of showing that it is "absolutely clear" the allegedly wrongful behavior will not recur.

Although this opinion provides practical guidance on drafting a covenant not to sue sufficient to defeat subject matter jurisdiction, parties considering such a move must carefully consider broader ramifications.

Background

Nike originally filed the lawsuit in federal court in the Southern District of New York, alleging that Yums' "Soulja Boys" and "Sugars" shoe lines infringed and diluted Nike's "Air Force 1" trade dress. Yums denied the allegations and filed a counterclaim contending that the Air Force 1 trade dress registration was invalid. Several months later, after settlement discussions, Nike issued a covenant not to sue, promising that Nike would not raise trademark or unfair competition claims based on any of Yums' existing footwear designs, or any colorable imitations thereof. Nike then moved to dismiss its own claims and Yums' invalidity counterclaim.

The district court granted Nike's motion. Construing the covenant broadly, the district court found that Yums lacked Article III standing to pursue its declaratory judgment counterclaim. The Second Circuit affirmed, finding it hard to conceive of a shoe that would infringe the Air Force 1 trademark yet not fall within the scope of the covenant. Yums appealed, and the Supreme Court granted certiorari in June 2012.

Mootness and Voluntary Cessation

The Supreme Court reaffirmed that Article III of the Constitution requires that an actual controversy exist not only at the time that the complaint is filed, but through all stages of the litigation. A case becomes moot, and thus no longer a "case or controversy," when the issues presented are no longer live or the parties lack a legally cognizable interest in the outcome.

The Court recognized, however, that a defendant cannot simply moot a case by ceasing the disputed conduct once it is challenged in court. Otherwise, a party could simply stop unlawful conduct when sued, and pick up again when the case is declared moot. Instead, when a party claims that its voluntary compliance moots a case, the Court applies the "voluntary cessation" doctrine. Under this doctrine, a defendant claiming that its voluntary termination of conduct moots a case "bears the formidable burden of showing that it is absolutely clear the allegedly wrongful behavior could not reasonably be expected to recur."

Nike's Covenant Not to Sue

Applying the voluntary cessation doctrine, the Court found that Nike's covenant met the heavy burden imposed by the voluntary cessation test. First, the covenant was unconditional and irrevocable; Nike could not simply change its mind and pursue Yums in the future. Second, the covenant prohibited Nike from not only filing suit, but also from making any claim or any demand. Thus, Yums was protected not only against future lawsuits, but other cease and desist letters, demands or threats that might place a cloud over its business activities. Third, the covenant reached beyond Yums to protect Yums' distributors and customers, protecting Yums from "downstream" IP claims. Fourth, the covenant covered not just current or previous designs, but any colorable imitations of those designs – thus protecting Yums' going forward.

In considering whether Nike met its burden, the Court also noted that Yums—despite ample opportunity to do so at all levels of the proceedings—had failed to identify any evidence of current or future shoe designs that would expose it to the prospect of infringement liability yet not be covered by the covenant: "If such a shoe exists, the parties have not pointed to it, there is no evidence that [Yums] has dreamt of it, and we cannot conceive of it. It sits, as far as we can tell, on a shelf between Dorothy's ruby slippers and Perseus's winged sandals."

Based on the language of the covenant not to sue and Yums' failure to show any evidence of a potentially infringing product, the Court found that the case was moot because the challenged conduct cannot reasonably be expected to recur.

Alternative Theories of Article III Injury and Policy Considerations

The Court also considered and rejected three alternative theories of Article III injury as insufficient to establish standing. First, Yums argued that as long as Nike remained free to assert its trademark, investors would be apprehensive about investing. The Court disagreed, finding that such investor decisions would be based on conjecture, which does not give rise to a "concrete" and "actual" injury necessary to establish Article III standing.

Second, Yums argued that, given Nike's decision to sue in the first place, Nike's trademarks would hang over Yums' operations "like a Damoclean sword" and that Nike might interfere with its distributors and customers. The Court rejected this argument on the grounds that the hypothetical misconduct would either be barred by the covenant, or was unrelated to Nike's trademark and would not be prevented by its invalidation.

Third, Yums made the sweeping argument that, as one of Nike's competitors, it inherently had standing to challenge Nike's intellectual property. The Court summarily rejected the premise that a market participant is injured for Article III purposes whenever a competitor benefits from something allegedly unlawful.

Fourth, the Court observed that, in the trademark context, covenants not to sue may be a risky long-term strategy for trademark holders, given that widespread use of a mark by third parties may be evidence of a lack of likelihood of confusion in future litigations, and because uncontrolled, or "naked," licensing may result in a loss of trademark rights. Thus, the concern that the case allowed Nike and other brand owners to bully small innovators was unfounded. The Court observed that adopting the position advocated by Yums, while benefitting the smaller competitor here, would actually enable larger companies with more resources to challenge the intellectual property portfolios of smaller competitors, thus enabling companies to "employ litigation as a weapon against their competitors rather than as a last resort for settling disputes."

Takeaways

This case provides helpful clarification that the "voluntary cessation" doctrine is alive and well, and that a party claiming that its change of conduct has mooted a case will bear a very heavy burden. In the intellectual property context, the case makes clear that a properly crafted covenant not to sue remains a viable option to end a declaratory judgment lawsuit. While this situation arises relatively rarely, the ability to terminate a lawsuit, rather than face ongoing litigation expenses or a uniquely bad outcome, may be a useful tool for IP owners managing broad portfolios or enforcement programs.

Nike's covenant not to sue, now blessed at the Supreme Court, will likely become the gold standard against which courts will scrutinize future covenants. Such agreements are more likely to survive scrutiny where they (1) are irrevocable and unconditional, (2) apply to all demands, not just lawsuits, (3) protect downstream customers, and (4) cover not just past and present conduct, but future infringement as well.

While a covenant not to sue that meets these requirements is likely to satisfy the "voluntary cessation" doctrine, Intellectual property owners should careful consider the broader implications of such covenants, and should bear in mind the potential risks and consequences to their IP rights.

As for Yums and similarly situated plaintiffs, this decision does not eliminate all recourse. A party claiming harm from a trademark registration may challenge it by pursuing opposition or cancellation proceedings before the Trademark Trial and Appeal Board. Likewise, parties may seek inter partes review or ex parte reexamination of patents. But this case reaffirms the core principle that federal courts are reserved for disputes over actual injuries.

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