Covenant Not to Sue: A Super Sack or Just A Wet Paper Bag?
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COVENANT NOT TO SUE:
A SUPER SACK OR JUST A WET PAPER BAG?

By Tal S. Benschar, David Kalow, and Milton Springut*

I. INTRODUCTION

Consider this scenario. An owner of intellectual property has filed suit, asserting infringement claims against a defendant, and now wants to end the case quickly—either because the suit is no longer economically viable or because there is a real threat that the owner's asserted rights will be declared invalid or significantly narrowed (such as through adoption of an unfavorable patent claim construction). But the defendant refuses to agree to a dismissal. What to do? The solution some litigants have used is to proffer a covenant not to sue the defendant. The plaintiff—intellectual property owner then argues that the case is now moot and any invalidity counterclaims (or counterclaims to cancel the asserted trademark registration) must be dismissed for lack of a live “case or controversy” under Article III of the United States Constitution.

The federal courts of appeals are split regarding whether upon such a proffer the case is now moot or the defendant should be allowed to continue with its counterclaims. The first appellate case to find this proffer tactic efficacious (meaning sufficient to moot the case and thus avoid an invalidity ruling) was Super Sack Manufacturing Corp. v. Chase Packaging Corp.,1 a patent case decided by the U.S. Court of Appeals for the Federal Circuit. More recently, the Second Circuit, in a trademark case, Nike, Inc. v. Already, LLC,2 agreed with the Federal Circuit’s reasoning. The Ninth Circuit, on the other hand, has held that the mere proffer of such a covenant does not moot the case.3 Now the Supreme Court has granted certiorari in the Nike case to resolve

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1. 57 F.3d 1054 (Fed. Cir. 1995).

2. 663 F.3d 89 (2d Cir. 2011), cert. granted, 80 U.S.L.W. 3480 (U.S. June 25, 2012) (No. 11-982). The Supreme Court heard oral argument on Nov. 7, 2012, and, as of the publication of this article, has not rendered its decision.

the split. If the Second Circuit’s holding is upheld, one can expect this litigation strategy to be employed more frequently in future cases.

However, there is a hidden danger in copying a patent litigation strategy in a trademark litigation. A major purpose of proffering the covenant is to preserve the owner’s rights for future enforcement against other parties. But, because of the unique legal nature of trademarks, proffering such a covenant may well lead to total or partial loss of the rights—the very result sought to be avoided.

This article (1) discusses the history of how courts have dealt with such proffers; (2) analyzes the jurisdictional issues dividing the courts, which are now before the Supreme Court; and (3) analyzes the effect of such a covenant not to sue on the rights of a trademark plaintiff with respect to other potential infringers.

II. HISTORY

A. Patent Cases

In Super Sack, the patent holder sued the defendant for infringing two patents concerning collapsible receptacle technologies. After discovery, the defendant sought to amend its counterclaims to add a claim for a declaration that the patents were unenforceable because of inequitable conduct. The plaintiff followed by proffering a promise that it would “unconditionally agree not to sue [the defendant] for infringement as to any claim of the patents-in-suit based upon the products currently manufactured and sold by [the defendant].”

5. Super Sack, 57 F.3d at 1056.

4. 80 U.S.L.W. 3480 (U.S. June 25, 2012) (No. 11-982). Until the split is resolved, it is even possible that both views could be applied in the same case. For example, in the recent Apple v. Samsung litigation, brought in the Northern District of California, Apple accused Samsung of infringing both design patents and trade dress rights. In such a case, the Federal Circuit has appellate jurisdiction; Federal Circuit law applies to patent issues, but regional circuit law applies to other issues in the case, such as trademark law. See, e.g., Nautilus Group, Inc. v. ICON Health & Fitness, Inc., 372 F.3d 1330, 1334 (Fed. Cir. 2004). Had Apple proffered a covenant not to sue, then the effect of that proffer on the trade dress claims would be governed by Ninth Circuit law, while its effect on the patent claims would be governed by Federal Circuit law.
In reviewing the district court’s dismissal for lack of subject matter jurisdiction, the Federal Circuit noted that generally a party seeking a declaratory judgment must show a concrete dispute between the parties. It further held that, even where the case was initiated by the plaintiff’s claim of infringement, it was the burden of the defendant seeking declaratory judgment in its counterclaim to show that there remained a continuing, real controversy once the plaintiff’s infringement claim was dismissed.6 The effect of the covenant was that the defendant had no cause to be concerned that it could be sued on the same patents for the same products it had already made or manufactured or sold to date.

With respect to possibly creating or designing new products, there was no evidence that the defendant had made any meaningful steps toward preparing new products that might be claimed to infringe the patent. Accordingly, there was a lack of a real controversy, and the dismissal for lack of subject matter jurisdiction was sustained.7

The Federal Circuit revisited the issue in 2007 in Benitec Australia Ltd. v. Nucleonics, Inc.8 It noted that, in the interim, the Supreme Court had decided MedImmune, Inc. v. Genentech, Inc.,9 which liberalized the standard for declaratory judgments and rejected the reasonable-apprehension-of-suit test, which had been the prevailing standard when the Super Sack decision was issued. Nevertheless, over a vigorous dissent by Judge Dyk, discussed below, the majority in Benitec Australia accepted that a properly formulated covenant not to sue would still moot the case because there were no adverse legal rights between the parties. Further adhering to Super Sack, the majority held that it was the defendant—counterclaimplaintiff’s burden to show that there was a continuing controversy that had been mooted. That burden was not met; the covenant not to sue thus mooted any controversy.10

B. Trademark Cases

In Nike, the Second Circuit expanded the Super Sack holding to encompass trademark litigation.11 Nike had filed suit claiming trademark infringement and unfair competition based on federal and New York law. According to the complaint, Nike designed and marketed an athletic shoe named the Air Force One and owned

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6. Id. at 1060.
7. Id.
8. 495 F.3d 1340 (Fed. Cir. 2007).
10. Benitec Australia, 495 F.3d at 1334-35.
federal trademark registrations for the shoe’s external decorative design. It further alleged that the defendant was selling confusingly similar imitations of that shoe. The defendant filed counterclaims for a declaratory judgment that the registered mark was not a valid trademark within the meaning of federal and state law and for cancellation of the registration pursuant to 15 U.S.C. § 1119.

After several years of litigation, and apparently concerned about the counterclaims, Nike proffered a covenant not to sue (see Appendix) and sought to dismiss the case. In affirming the district court’s dismissal based on lack of subject matter jurisdiction, the Second Circuit noted that the prior two-pronged test for a controversy that included a “reasonable apprehension of suit” had been affectively abrogated by the Supreme Court in the MedImmune case. Nevertheless, under MedImmune, the party seeking a declaratory judgment bears the burden of showing a continuing controversy, and in this case the covenant not to sue effectively mooted any controversy.

The Second Circuit noted that Nike’s covenant covered both past and future sales of any existing product and color combination and accordingly protected the defendant from almost any conceivable charges of infringement. It rejected the defendant’s argument that its investors feared for future infringement suits and for that reason had refrained from investing in the defendant or had withdrawn their investments. Given the covenant’s broad application, the fear of loss of investments failed to establish genuinely adverse legal interests between the parties. The Second Circuit also specifically rejected the view (discussed below) that the burden was on the plaintiff to show that subject matter jurisdiction was lacking.12

Turning to the cancellation counterclaim, the Second Circuit noted that the statute provides that in order to bring cancellation claims in district court, there must be an “action involving a registered mark” in which the district court can determine the right to the registration. This means that a controversy as to the validity of or interference with the registration must exist before a district court has jurisdiction to grant cancellation. In the Nike case, given that the controversy had been mooted by the covenant not to sue, there was no remaining basis for the defendant to cancel the plaintiff’s registration.13

C. The Opposing View

The views of the Federal Circuit in Super Sack and the Second Circuit in Nike are not universally held. In Bancroft & Masters,

12. Id. at 97-98.
13. Id. at 98.
Inc. v. Augusta National, Inc., the Ninth Circuit dealt with a trademark case concerning use and registration of a domain name incorporating the plaintiff’s trademark. The Ninth Circuit rejected the argument that plaintiff’s offer to dismiss all trademark and unfair competition claims against the defendant mooted the case. It held that, under controlling circuit law, once a controversy was established, the burden shifted to the plaintiff to show that it was “absolutely clear” that it would never seek to prevent the defendant from using the allegedly infringing mark. It also held, contrary to the decision in the Nike case, that the cancellation proceeding was a separate cause of action and did not require an ongoing controversy.

In his dissent in the Benitec Australia case, Circuit Judge Dyk noted that he would have held that once there was an actual controversy at the beginning of the case, the burden shifted to the plaintiff to show that any counterclaims of invalidity were moot. As the plaintiff in Benitec Australia had brought a claim of patent infringement when it initiated the action, at that point there clearly was a controversy adequate to support subject matter jurisdiction. In that situation, Judge Dyk believed that Supreme Court precedent, specifically Cardinal Chemical Co. v. Morton International, Inc., then shifted to the plaintiff the burden of proving that such issues had been completely mooted and no possibility of a controversy over the same issues existed.

The majority in Benitec Australia, however, limited Cardinal Chemical to issues of appellate jurisdiction—specifically to cases, such as Cardinal Chemical itself, where the district court had entered both a judgment of non-infringement and a declaratory judgment of invalidity. The Court in Cardinal Chemical held that the mere fact that the Federal Circuit had affirmed the judgment of non-infringement did not moot the invalidity issue, as both could possibly still be reviewed by the Supreme Court. In that situation, it was up to the party claiming that intervening circumstances had mooted the case to prove that contention. However, the majority in Benitec Australia held that the Cardinal Chemical rule applied only to appellate jurisdiction and had no application to a case in the district court before any judgment had been entered. In the latter situation, the burden always rests with the counterclaim
plaintiff to prove that there is subject matter jurisdiction, including that there remains a “case or controversy” to resolve.21

III. THE REAL ISSUE BEFORE THE SUPREME COURT: THE REQUIRED SCOPE OF A COVENANT NOT TO SUE

A. Burden of Proof Not the Sole Issue

The issue of whether a covenant not to sue is effective to moot the case and require dismissal is now before the Supreme Court in the Nike case. The question on which the Court granted review is:

Whether a federal district court is divested of Article III jurisdiction over a party’s challenge to the validity of a federally registered trademark if the registrant promises not to assert its mark against the party’s then-existing commercial activities.22

At first blush, it would appear that the main point of contention between the authorities (the Federal and Second Circuits on one side, the Ninth Circuit and Judge Dyk on the other) has to do with burden of proof. While that issue is certainly part of the dispute, in the authors’ view it would be a mistake to conceive of the dispute as so limited. Even assuming that the burden is on the party proffering the covenant to prove that the case is mooted, and that such proof must be “absolutely clear,”23 the question remains why the proffer itself does not reach the level of requisite proof. After all, there is no question that, assuming the proffer is effective, the proffering plaintiff will be bound by its covenant and will be estopped from asserting claims covered by its terms;24 indeed, the plaintiff is bound even by its counsel’s explanation of the details of the covenant to the court. To the extent that any of the defendants’ acts are covered by the covenant, that part of the case clearly has been resolved—regardless of who bears the burden.

To illustrate the point, suppose the plaintiff–intellectual property owner were to proffer a covenant not to sue in which it promised not to sue on any infringement of the same

21. Benitec Australia, 495 F.3d at 1345; accord Nike, 66 F.3d at 98.
24. See Super Sack Mfg. Corp. v. Chase Packaging Corp., 57 F.3d 1054, 1059 (Fed. Cir. 1995). In Super Sack, the Federal Circuit rejected the contention that the covenant was not binding because it was contained in motion papers signed by counsel, not a covenant signed by its officers. Citing to Link v. Wabash R.R. Co., 370 U.S. 626, 633-34 (1962), the appellate court held that the statements of counsel, as agent of the plaintiff, bound the company. See Super Sack, 57 F.3d at 1059.
rights (patent, trademark, copyright) asserted in the suit, whether past or future, and on any product designs. Such a broad covenant clearly would moot the suit—the defendant has free rein to use that intellectual property however it wants, and has no legal need to have it declared invalid. This is so regardless of who bears the burden on mootness—the covenant would make it “absolutely clear” that there is no controversy. Thus, under all authorities, a sufficiently broad covenant should moot the case.

**B. Scope of the Covenant Is the Primary Dispute**

Of course, plaintiff–intellectual property owners generally have not proffered such a broad covenant. And, even under the *Super Sack* view, not every covenant not to sue moots the case. “Whether a covenant not to sue will divest the trial court of jurisdiction depends on what is covered by the covenant.” The more basic issue dividing the courts, it appears, is not who bears the burden of showing mootness, but the scope and breadth needed in the covenant to moot the case.

In analyzing the coverage of a covenant, courts distinguish between “activities” and “products.” “Activities” refers to actions taken by the defendant that would infringe the asserted intellectual property—generally, marketing infringing products. “Products” refers not to individual goods but rather to the design of items being marketed or exploited. Thus, for example, if the defendant in *Nike* were to manufacture and sell additional sneakers with the same allegedly infringing design, that would be a new “activity” (sales, offers for sale) of an old “product” (sneakers with the same accused design). If, on the other hand, it created and sold sneakers bearing new designs, this would be a new “product.”

25. We think it is clear that there is no need for the proffered covenant to cover other intellectual property not asserted in the suit. For example, the trademark register reveals that Nike owns more than 300 trademark registrations and pending applications for registration, yet only one was asserted in the *Nike* case. Because the defendant had never been accused of infringing any of Nike's other marks, there is no controversy between the parties to resolve over their validity.

26. *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*, 556 F.3d 1294, 1297 (Fed. Cir. 2009) (holding that the proffered covenant not to sue was insufficiently broad).

27. *See Nike*, 663 F.3d at 96 n.3.

28. More precisely, in patent cases an infringer is defined as “whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States, or imports into the United States any patented invention during the term of the patent therefor.” 35 U.S.C. § 271(a). In trademark cases, infringement is defined as the “use in commerce” of any imitation of a mark “in connection with the sale, offering for sale, distribution, or advertising of any goods or services. . . .” 15 U.S.C. § 1114(1)(a). In copyright cases, an infringer is defined as “[a]nyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 122 [of the Act].” 17 U.S.C. § 501. These rights include reproducing the copyrighted work, creating derivative works, and distributing copies of the work by sale or rental. *Id.* § 106.
Review of the case law reveals four categories that a plaintiff potentially must include in its covenant:

1. Past Activities. Clearly, a plaintiff seeking to moot a case through a covenant not to sue must agree to release all claims for past infringement. Any charge of infringement of a patent, trademark, or copyright necessarily implicates the validity of the asserted intellectual property, as only valid intellectual property can be the basis of a suit. And, while an issued patent or a registered trademark or copyright is presumed valid, the defendant generally is entitled to challenge that presumption. Thus, any charge of past infringement necessarily creates a justiciable controversy on the validity issue.

2. Future Activities Based on Past Products. Releasing past claims for past infringement generally will be insufficient to moot the case. In *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*, the Federal Circuit noted that the proffered covenant covered only past activities but would not bar the plaintiff from suing on the same patents for the defendant’s repetition of the same acts in the future. That reservation distinguished the case from *Super Sack* and *Benitec Australia* and meant that a real controversy continued. During the litigation, the defendant had stopped selling the goods at issue but had retained an inventory of the accused product. The plaintiff stated that it would return to court if the defendant re-entered the market with those products. Given that the defendant was ready and able to re-enter the market with the very same products previously accused of being infringing, and that the plaintiff had reserved to itself the right to sue on the basis of those products, the case was not moot.

In most cases (meaning unless the defendant has determined to stop marketing the type of goods that implicate the intellectual property at issue), it appears that a covenant must include, at the very least, future activities based on past designs. The defendant already marketed products with a design accused by the plaintiff of infringement, and it is reasonable to assume that the defendant would continue or resume marketing the same type of product in the absence of an infringement charge. There is certainly nothing speculative about a defendant’s asserting that it wishes to do more of the same activities, and if those same activities incurred a charge of infringement in the past, there is no reason to think they will not do so in the future.

29. See 17 U.S.C. § 410(c) (copyright registration is prima facie evidence of validity if made within five years of first publication); 35 U.S.C. § 282 (patents presumed valid); 15 U.S.C. § 1057(b) (certificate of registration is prima facie evidence of validity of the registered mark).

30. 556 F.3d 1294 (Fed. Cir. 2009).

31. See id. at 1298-99.
3. Future Activities Based on Currently Planned Products. Suppose the defendant has taken concrete steps to create new designs, perhaps in an attempt to design around the asserted intellectual property. These steps might include actual creation of a new design (e.g., by an industrial designer employed by the defendant), ordering from a contract manufacturer of new components or new goods bearing the new design, and ordering of tooling to produce the new design.

Courts have dealt with this category only indirectly, by negative implication. In Super Sack, for example, the Federal Circuit noted that the defendant had “never contended that it ha[d] already taken meaningful preparatory steps to make a new product [i.e., with a new design] that [could] later be said to infringe.”32 Similarly, in Nike, the Second Circuit held that “given the absence of record evidence that [the defendant] intends to make any arguably infringing shoe that is not unambiguously covered by the Covenant, this hypothetical possibility does not create a ‘definite and concrete’ dispute.”33 In Benitec Australia, the majority held that a proffer by the defendant that it was in a “discussion” with potential business partners to expand to new uses of the accused composition, and had even executed a confidentiality agreement as a preliminary step to such a business deal, was insufficient to sustain jurisdiction as being too indefinite.34 The implication of all these cases is that, at some point, sufficiently definite and concrete plans to create and market new designs are sufficient to create a justiciable controversy.

It is in this, third, category that the burden of proof could make a difference. The Federal and Second Circuits place the burden on the defendant—counterclaim-plaintiff to come forward with evidence sustaining continued jurisdiction, which would include proving that it has concrete and definite plans to expand to marketing new designs. The Ninth Circuit and Judge Dyk, on the other hand, would require the plaintiff to prove the negative—that the defendant has no such plans. There is a dictum in Cardinal Chemical that suggests that the defendant should not be required to come forward with evidence of its future plans.35 The Ninth Circuit and Judge Dyk applied Cardinal Chemical to the trial court’s jurisdiction to shift to the plaintiff the burden of showing loss of jurisdiction, so presumably they would hold that the

32. Super Sack, 57 F.3d at 1057.
33. Nike, 663 F.3d at 97 n.5.
35. Cardinal Chem. Co. v. Morton Int’l, 508 U.S. 83, 100 (1993) (“Given that the burden of demonstrating that changed circumstances provide a basis for vacating the judgment of patent invalidity rests on the party that seeks such action, there is no reason why a successful litigant should have any duty to disclose its future plans to justify retention of the value of the judgment that it has obtained.”).
defendant has no duty to come forward with evidence of future plans.

That said, even if the burden of proving mootness were placed on the plaintiff, there is no reason that the plaintiff should not be able to use discovery to find out whether the defendant has any plans to create and market new designs, and if so, how concrete and definite they are. Discovery generally is available to help resolve any factual issues in a case—including issues of jurisdiction.\(^{36}\) Indeed, in some cases, discovery in aid of proving jurisdiction is mandatory, and dismissal for lack of jurisdiction without adequate time to conduct discovery may be reversed as an abuse of discretion.\(^{37}\) Discovery of a defendant’s future plans, if any, seems particularly appropriate because generally a party’s future business plans are known only to it and its officers and employees. There is no reason that a court, by permitting appropriate discovery, cannot ascertain whether a declaratory judgment plaintiff (or counterclaim plaintiff) has definite and concrete plans to create and market new designs sufficient to sustain a claim of jurisdiction. To the extent that there are such concrete and definite plans, a plaintiff wishing to moot a case would have to include the designs that are the subject of those plans in its proffered covenant not to compete.

Of course, that then raises the question of just how far along in its plans to market an infringing product a party has to be to sustain a claim of jurisdiction under Article III’s case or controversy requirement. Both courts and commentators have struggled with that issue. One court summarized its understanding of the law as follows:

A review of the cases demonstrates that where a party has not yet identified a name or location of a business, or has not secured—or attempted to secure—the central components of the formula ordinarily required for production, the case or controversy standard is unlikely to be satisfied. . . .

Where, however, a party has produced prototypes or samples of the allegedly infringing products, begun soliciting—and advertising to—potential customers, or otherwise invested significant sums of money in preparation for producing the goods, the case or controversy requirement is likely to be satisfied.\(^{38}\)

The Federal Circuit takes a strict approach, requiring both “immediacy” and “reality” of the infringement—essentially that the declaratory judgment plaintiff be ready to enter the market with an infringing product. This approach has been criticized as


\(^{37}\) See Eaton v. Dorchester Dev., Inc., 692 F.2d 727, 729-21 (11th Cir. 1982).

too strict and inconsistent with the Supreme Court’s decision in *MedImmune, Inc. v. Genentech, Inc.* Formulating an exact standard is fact-intensive, and is in any case beyond the scope of this article. Whatever the parties’ then-current plans are, they would have to be evaluated under the relevant law to determine whether they are sufficiently real and immediate (assuming that is the proper test) to sustain jurisdiction.

4. **Future Activities Based on Future Products.** What if a party has no definitive plans to create or market new designs? Does the fact that it *might* do so, combined with the fact of the past accusation or claim of infringement, suffice to establish a case or controversy? At first blush, the answer seems to be clearly not—such a possibility seems too remote and speculative. That is indeed what the Federal and Second Circuits have held.

But there is a contrary argument. In *Cardinal Chemical*, the Court noted that “a company once charged with infringement must remain concerned about the risk of similar charges if it develops and markets similar products in the future.” In *Benitec Australia*, Judge Dyk, relying on this dictum, would have held that such a future possibility was sufficient to sustain jurisdiction—even though he conceded that, in the first instance, such a possibility would have been too remote to sustain a declaratory judgment case. The shift of burden of proof, in his view, means that it becomes the burden of the plaintiff to *disprove* this future possibility.

The authors find Judge Dyk’s argument hard to sustain. Burden of proof concerns who is responsible for coming forward with proof to ascertain the pertinent facts—not whether those facts suffice to meet a party’s burden. Suppose the plaintiff in *Benitec Australia* had taken discovery and shown that the defendant had no concrete plans for new designs. Judge Dyk

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40. Interestingly, in *Nike*, the plaintiff offered a covenant more generous than was probably required—one that covered not only all past infringing designs but also any colorable imitations of such designs. At oral argument, however, it argued that its covenant would not cover an “exact copy” of its trade dress design, which would be actionable as a “counterfeit” and not merely a colorable copy of the registered design. *Nike*, 663 F.3d at 97 n.5.

41. *Id.* (“given the absence of record evidence that [defendant] intends to make any arguably infringing shoe that is not unambiguously covered by the Covenant, this hypothetical possibility does not create a ‘definite and concrete’ dispute.”); *Super Sack*, 57 F.3d at 1059-60 (“The residual possibility of a future infringement suit based on [its] future acts is simply too speculative a basis for jurisdiction over [its] counterclaim for declaratory judgments of invalidity.”).

42. 508 U.S. at 99-100.

43. *Benitec Australia*, 495 F.3d at 1354.

44. *Id.*
conceded that such a situation would be insufficient to sustain jurisdiction on a plaintiff’s claim for declaratory judgment asserted in a complaint. Why, then, should it be sufficient to sustain jurisdiction merely because the party seeking a declaratory judgment is a defendant asserting a counterclaim?

That having been said, we believe that, in some cases, there is another way to sustain jurisdiction: the need for a design-around and its impact on the defendant’s business. Commenting on the Supreme Court’s above-quoted observation that a party once charged with infringement needs to be concerned about the risk of future claims, one district court astutely noted: “Because of that risk, a defendant in a patent case does have something to gain from a counterclaim declaration of invalidity. Such a declaration frees the defendant to continue modifying and developing its products in the art at issue without fear that any changes will convert that which previously did not infringe into something that does.”

The fact that one party owns existing valid intellectual property, by statute presumptively valid, may profoundly impinge on the business activities of its competitors. Faced with such intellectual property, competitors are forced to “design around” to create a non-infringing product. While it is true that infringement is not imminent in such a case—the whole point of designing around is to avoid infringement—there is no reason that the requirement for designing around cannot create a justiciable controversy. After all, the declaratory judgment plaintiff in MedImmune also was in no danger of infringing on the patent at issue, so long as it continued to pay license fees to the patent owner. Yet, the Supreme Court sustained jurisdiction in that case, because such contractual payments were quite real and, legally, depended upon the validity of the patent.

“Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.” Where one party’s intellectual property is forcing another party to try to adopt different, non-infringing designs (which might be functionally or aesthetically inferior, and hence less marketable), it would appear that the standard is met.

45. See text accompanying note 43.
48. Id. at 130-34.
49. Id. at 127 (quoting Maryland Cas. Co. v. Pacific Coal & Oil Co., 312 U.S. 270, 273 (1941)).
This is analogous to the government-coercion cases cited by the Supreme Court in *MedImmune* in its analysis. In such cases, a party that is faced with an unconstitutional or legally invalid law (e.g., a law prohibiting distribution of handbills at a mall, arguably contrary to the First Amendment) is not required to violate the statute before challenging it with a declaratory judgment. “In each of these cases, the [declaratory judgment] plaintiff had eliminated the imminent threat of harm by simply not doing what he claimed the right to do [but the statute prohibited]. That did not preclude subject-matter jurisdiction because the threat-eliminating behavior was effectively coerced.” Likewise, a party’s design-around efforts are “effectively coerced” by the existence of a patent, trademark, or copyright.

Of course, the extent of coercion to design-around depends on the nature of both the defendant’s business and the industry in which the defendant competes. Not all businesses accused of infringement are alike. Some run businesses that engage in regular, extensive efforts to create new product designs—a process often referred to as “research and development” in the more technical industries. Others do little of that, instead simply dealing with whatever designs might be currently available from wholesale sources. Clearly, a business that does little design creation itself is hardly in a position to claim this kind of injury from the existence of intellectual property. However, for many businesses that regularly invest substantial sums in design (or research and development), the impingement of intellectual property on their business could well be as real as the royalty payments in *MedImmune*.

This variability expands when one considers industries as a whole. In some industries, improvements and new versions proliferate. The Apple iPhone, for example, seems to have new features or versions introduced on a regular basis. In others, competitors may sell a successful design for years before seeking a “new and improved” version.

Second, the fact and scope of the covenant not to sue may, in some cases, greatly reduce the pressure to design around. After all, the plaintiff has provided a defendant with a partial license to exploit its intellectual property—to the extent of the scope of the covenant. In some cases that may be sufficient for the defendant’s business, obviating the need for a design-around; in others, it may not. In yet other cases, a defendant that is constantly creating new designs may still have to be worried that it may inadvertently infringe part of the intellectual property not within the scope of the covenant not to sue.

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50. *Id.* at 128-29.
51. *Id.* at 129.
In the Nike case, for example, Nike covenanted not to sue for any use of a “colorable imitation” of its trade dress sneaker design, but left open the possibility of future suit for sale of a counterfeit—which the Second Circuit understood as an exact copy. If the defendant’s business includes ongoing creation of new sneaker designs, then, even with Nike’s covenant, the defendant would always have to worry that Nike might consider a new design to be a counterfeit, which would expose it to possible suit and liability.

In short, whether a party that has been accused of infringement and that receives a proffer of a covenant not to compete still has a justiciable need to declare the intellectual property rights of the accuser invalid will depend on a host of factual variables.

As noted above, the Supreme Court in the Nike case has granted certiorari to determine “[w]hether a federal district court is divested of Article III jurisdiction over a party’s challenge to the validity of a federally registered trademark if the registrant promises not to assert its mark against the party’s then-existing commercial activities.” The answer to that question—as is the answer to many legal questions—is, we submit, “It depends.” Following is a suggested factual analysis:

1. Does the defendant have any present plans for new designs? If so, how complete are they? (How far along these plans need to be is a significant legal question that must be answered at some point, though probably not in the Nike case.)

2. What is the nature of the defendant’s business model and the industry in general? Is there constant innovation and improvement of product design, or is change slow such that the need for new designs is not imminent?

4. Is the existence of the previously asserted intellectual property coercing the defendant to create or adopt new, non-infringing designs that it would not do if the intellectual property were declared invalid? Is there still the presence of such coercion after proffer of the covenant not to sue?

These questions can be answered regardless of which party bears the burden; all that is needed is reasonably sufficient time for discovery. If the plaintiff still wishes to moot the case, it will have to broaden its proffer of a covenant not to compete to include the future activities that are real enough to sustain jurisdiction. That, of course, will vary depending on the facts of the case.

52. Nike, Inc. v. Already, LLC, 663 F.3d 89, 97 n.5 (2d Cir. 2011), cert. granted, 80 U.S.L.W. 3480 (U.S. June 25, 2012) (No. 11-982). See also 15 U.S.C. § 1127 (defining a counterfeit as “a spurious mark which is identical with, or substantially indistinguishable from, a registered mark”).
IV. EFFECT OF CONVENANT NOT TO SUE ON TRADEMARK RIGHTS

Above, we analyzed the effect of covenants not to sue on federal jurisdiction—the issue now before the Supreme Court in Nike. As we noted there, the primary question is not which party has the burden of proof but, rather, how broad the scope of the covenant must be—which will vary from one case to another. In any event, if sufficiently broadened, a proffered covenant should moot the case. In this section we discuss the effect of a covenant not to sue (assuming such is drafted broadly enough to moot the case) on trademark rights.

The purpose of proffering a covenant not to sue is to preserve the party’s intellectual property for future assertion against other parties while recognizing that the only way to do so is to allow the defendant in that suit to continue its infringing activities. Given the defendant’s relative size in comparison to other infringers and the importance of the intellectual property, this may well be an appropriate trade-off. But this assumes that proffering a covenant not to sue will have little effect on the validity of the intellectual property itself, and merely permits infringement by the particular defendant(s) in the suit. While that may be a generally valid assumption in patent cases, in trademark cases such an assumption is suspect.

A. Special Status of Trademarks as Property

Trademarks are a unique and somewhat peculiar form of property. The Supreme Court long ago held:

There is no such thing as property in a trade-mark except as a right appurtenant to an established business or trade in connection with which the mark is employed. [A trademark’s] function is simply to designate the goods as the product of a particular trader and to protect his good will against the sale of another’s product as his; and it is not the subject of property except in connection with an existing business.53

The Lanham Act reflects this understanding. A trademark is defined to include “any word, name, symbol, or device, or any combination thereof” that a person uses or has an intent to use “to identify and distinguish his or her goods, including a unique product, from those manufactured and sold by others and to indicate the source of the goods, even if that source is unknown.”54 (A service mark is similarly defined.)55 Thus, a trademark is merely a symbol of an ongoing business that is the source or

55. Id.
sponsor of the goods or services at issue. In the words of the Rectanus Court, a trademark is merely “appurtenant” to the goodwill of an existing business.

The unique nature of trademarks as property results in many differences between trademark law and patent and copyright law. To cite one basic example, while a patent owner can prevent any use or commercial exploitation of his patented design, a trademark owner can prevent only uses that are likely to cause confusion as to the source or sponsorship of the product or service.56 As Justice Holmes famously remarked:

Then what new rights does the trade-mark confer? It does not confer a right to prohibit the use of the word or words. It is not a copyright. . . . A trade-mark only gives the right to prohibit the use of it so far as to protect the owner’s good will against the sale of another’s product as his. . . . When the mark is used in a way that does not deceive the public, we see no such sanctity in the word as to prevent its being used to tell the truth. It is not taboo.57

Another important difference is that actions that inhibit or destroy a mark’s capacity to symbolize the source may be construed by a court as constituting an abandonment of the trademark. The way a trademark owner acts (or fails to act) with respect to one infringer or potential infringer may very well undermine the general validity (and, hence, enforceability) of its mark by undermining the mark’s ability to function as a symbol of source. This is quite different from a patent. The mere fact that a patent owner tolerates or even licenses one party to use its patent generally does not affect the validity of its patent against other infringers.

There are three related trademark doctrines where this concept has been applied: (1) failure to enforce; (2) naked licensing; and (3) consent to use agreements, also known as coexistence agreements. To date, no court has attempted to construe a covenant not to sue in terms of substantive trademark law. Below we discuss each of these doctrines and analyze whether such a covenant would fit into any of them, and if so what the effect on the trademark owner’s rights would be.

B. Failure to Enforce

The most obvious way to construe a covenant not to sue is as the failure to enforce a mark. Clearly, the plaintiff in Nike decided not to enforce its rights in that suit, and to that extent it failed to enforce its rights against that particular infringer.

Unfortunately, the law in this area is quite muddled. According to a leading trademark treatise, there are no fewer than three positions as to the effect against a second infringer in a later case of a failure to enforce a trademark against an earlier infringer. One view is that the effect is irrelevant because “a defendant cannot rely upon the wrongdoing of others to exculpate itself from its own infringing activities.” A second position is that the failure to enforce constitutes an abandonment of the trademark. A third, middle position endorsed by Professor McCarthy, is that the failure to enforce is only partially relevant in that it may show a weakening of the plaintiff’s mark through use by others in the market.

Thus, according to McCarthy, the mere fact that there is an infringer that the plaintiff chooses not to pursue is not per se a loss of rights. However, where numerous products in the marketplace bearing their mark are manufactured and produced by those unconnected to the trademark owner, the ability of the alleged mark to function as a trademark, that is, as a symbol of the trademark owner as the source of the products, is diminished and possibly completely lost. The Supreme Court faced such a situation in the classic case of Saxlehner v. Eisner & Mendelson Co., where it held that the failure to enforce rights in the asserted mark (HUNYADI, for Hungarian mineral waters) for some 20 years, and the widespread use of the same mark by numerous other competitors, meant that there was a complete loss of rights in the trademark.

Under this theory, a covenant not to sue cannot be judged in a vacuum. Rather, one must look at the volume of products actually produced and marketed under the covenant and the effect, if any, on the perception of the public regarding the trademark or trade dress that was the subject of the covenant and its association with the trademark owner. Notably, while in Nike the covenant stated that Nike had “recently learned” that the amount of infringement was too small to justify the further costs of litigation, the covenant by its terms was unlimited as to quantities and nothing (other than economic realities) would prevent the defendant from flooding the market with imitations covered by the covenant. Thus, the effect of a covenant not to sue under a failure-to-enforce theory

60. See 3 McCarthy, supra note 58, § 17:17.
61. 179 U.S. 19 (1900).
62. See id. at 36-37.
is, simply, unknown; it depends on the extent of the defendant’s manufacture and marketing of products within the covenant and the effect of such activities on consumer perception in the marketplace.

In the authors’ view, however, equating a covenant not to sue with a mere failure to enforce is problematic. The reason courts are reluctant to require complete enforcement by the trademark owner is that it is financially onerous and could create a flood of lawsuits. Not surprisingly, courts tolerate a trademark owner’s failure to enforce where the amounts are minimal or other enforcement priorities are manifest. The difference between a failure to enforce and a covenant not to sue, however, is that a failure to enforce can always be reversed by the trademark owner, subject only to the defense of laches. A trademark owner could, for example, legitimately not enforce its trademark against an infringer whose quantities are only small, reserving to itself the right to begin enforcement if the infringer later expands its infringing activities to create a more serious problem.

In contrast, the trademark (or trade dress) owner that proffers a covenant not to sue in litigation must bind itself not to sue on any infringements of like character (i.e., same mark or trade dress and same goods) indefinitely into the future, no matter what the quantities produced or sold. The defendant in Nike would be within its rights to manufacture an infinite number of sneakers with the same design as those that precipitated Nike’s suit. This is a far more significant undermining of trademark rights then a mere decision not to enforce against a particular infringer.

C. Naked License

Another doctrine of trademark law that appears applicable to a covenant not to sue is that of naked licensing. A product, under trademark law, is not genuine unless it has been manufactured and distributed either by the trademark owner or under the owner’s quality control. This means that the trademark owner has not only the right, but also the duty, to control the quality of goods that it licenses.

64. See, e.g., Playboy Enters., Inc. v. Chuckleberry Publ’g, Inc., 486 F. Supp. 414, 422-23 (S.D.N.Y. 1980), aff’d, 687 F.2d 563 (2d Cir. 1982) (“The owner of a mark is not required to police every conceivably related use thereby needlessly reducing non-competing commercial activity and encouraging litigation in order to protect a definable area of primary importance.”).

65. The defense of laches has been denied under the doctrine of “progressive encroachment” where, inter alia, the initial infringement was only small and later grew to quantities or scope of distribution that threatened the mark. See 3 McCarthy, supra note 58, §§ 31:19-20. Similarly, courts have excused a trademark owner that delayed in suing one defendant because it was burdened by enforcement costs against other infringers. See id. § 31:16.
When the trademark owner fails adequately to control the quality, there is a potential for consumer deception. Consumers are likely to believe that the trademark owner stands behind the goods, when in fact they have been made without the owner’s control. A license without adequate quality control measures is termed a “naked” license, and has been condemned as a fraud on the public and unlawful.\textsuperscript{66} In many cases, a naked license can lead to forfeiture of trademark rights.\textsuperscript{67}

The mere fact that a covenant not to sue is labeled a “covenant” versus a “license” appears to be of no moment. The Supreme Court long ago observed (in a patent case) that as a license passes no interest in the patent, it is “a mere waiver of the right to sue by the patentee.”\textsuperscript{68} That observation has been echoed in numerous appellate cases since then.\textsuperscript{69} One court observed, in the specific contest of trademark licenses, that “[c]ourts have construed a variety of agreements and relationships entered into for a range of reasons, including the cessation or forbearance of litigation, to be trademark licenses subject to the naked licensing defense.”\textsuperscript{70}

A covenant not to sue that is broad enough to moot a case grants the defendant unlimited authorization to use the mark on designs that the plaintiff had previously accused of being infringing, and indeed even continues to maintain are infringing. Thus, a covenant not to sue is open permission for the defendant to continue to manufacture infringing goods without any quality control whatsoever. That is the very essence of a naked license.\textsuperscript{71}

1. Effect of Naked Licensing on Trademark Rights

According to many authorities, naked licensing results in abandonment of all\textsuperscript{72} rights in the trademark and may result in

\begin{itemize}
\item \textsuperscript{66} See Société Comptoir de L'Industrie Cotonnière Établissements Boussac v. Alexander’s Dep’t Store, Inc., 299 F.2d 33 (2d Cir. 1962); Dawn Donut Co. v. Harts Food Stores, Inc., 267 F.2d 358 (2d Cir. 1959).
\item \textsuperscript{67} See discussion infra.
\item \textsuperscript{68} De Forest Radio Tel. & Tel. Co. v. United States, 273 U.S. 236, 242 (1927).
\item \textsuperscript{69} See Transcore LP v. Electronic Transaction Consultants Corp., 563 F.3d 1271, 1276 (Fed. Cir. 2009) (collecting cases).
\item \textsuperscript{70} Exxon Corp. v. Oxxford Clothes, Inc., 109 F.3d 1070, 1077 n.9 (5th Cir. 1997) (collecting cases).
\item \textsuperscript{71} Cf. Eva’s Bridal Ltd. v. Halanick Enters., Inc., 639 F.3d 788, 791 (7th Cir. 2011) (arrangement whereby defendant was permitted by plaintiff to use its mark without any decision-making authority over the quality represented the “paradigm of a naked license”).
\item \textsuperscript{72} Whether naked licensing results in abandonment is not necessarily an all-or-nothing question. Recently, in Patsy’s Italian Restaurant, Inc. v. Banas, 653 F.3d 254 (2d Cir. 2011), the Second Circuit held that a finding of abandonment through naked licensing could be limited to a particular geographical area where the naked licensing took place without resulting in the abandonment of the mark in the rest of the United States. Id. at 264-65. That court also opined that the same rule might apply in different markets—for
\end{itemize}
cancellation of the registration. Many of the earlier cases state that proposition directly,\textsuperscript{73} and that assertion has been repeated more recently.\textsuperscript{74}

However, some cases suggest that more needs to be shown than one instance of a naked license. In \textit{Exxon Corp. v. Oxxford Clothes, Inc.},\textsuperscript{75} the Fifth Circuit noted that the Lanham Act does not directly use the term “naked licensing.” Rather, the Act defines “abandonment” as follows:

A mark shall be deemed to be “abandoned” if either of the following occurs:

1. When its use has been discontinued with intent not to resume such use. Intent not to resume may be inferred from circumstances. Nonuse for 3 consecutive years shall be prima facie evidence of abandonment. “Use” of a mark means the bona fide use of such mark made in the ordinary course of trade, and not made merely to reserve a right in a mark.

2. When any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark. Purchaser motivation shall not be a test for determining abandonment under this paragraph.\textsuperscript{76}

The consensus of federal case law is that “naked licensing” fits into subsection (2).\textsuperscript{77} That provision differs from subsection (1) in that no intent to abandon is required, and indeed the Fifth Circuit affirmed that no such intention is required for a naked licensing defense.\textsuperscript{78} On the other hand, subsection (2) does require that the owner’s conduct cause the mark “to lose its significance as a mark.” This means that to sustain a defense of naked licensing, a defendant must show that the licensing resulted in loss of

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example, naked licensing in the retail market might not be an abandonment of the mark in the wholesale market. \textit{See id.}

Thus, it is conceivable that a covenant not to sue could be construed as a partial abandonment for trademark uses (i.e., the same marks and goods) within the terms of the covenant, retaining the rights to uses outside the covenant’s terms (e.g., new variations on the mark or new types of goods). As is discussed below, it appears that Nike attempted to preserve such an argument before the Second Circuit.

73. \textit{See} 3 McCarthy, supra note 58, § 18:48 n.9 (collecting cases).

74. \textit{See} Eva’s Bridal Ltd. v. Halanick Enters., Inc., 639 F.3d 788 (7th Cir. 2011); Barcamerica Intl USA Trust v. Tyfield Importers, Inc., 289 F.3d 589 (9th Cir. 2002).

75. 109 F.3d 1070 (5th Cir. 1997).


77. \textit{See Exxon}, 109 F.3d at 1078 (collecting cases).

78. \textit{Id.} at 1079.
trademark significance—which the Fifth Circuit equated with commercial distinctiveness.79

This result, taken to its extreme, would mean that naked licensing is no different from failure to enforce,80 and unless it were shown that in the perception of the public the mark lost all commercial distinctiveness, the defense would not be made out. In our view, for the reasons discussed below, such a conclusion would be improper, and trademark owners are ill advised to rely on it.

a. Exxon Case Concerned Phase-Out Agreements

Caution should be taken in placing too broad a reliance on the Exxon case. The license at issue in Exxon was different from the typical “naked license.” Exxon had embarked on a trademark enforcement program to protect its mark. As part of that effort, in lieu of litigation, it entered into “phase-out agreements” with many accused infringers that permitted them to sell off any remaining inventory in exchange for a promise not to resume infringement thereafter and a general release. While in the short term such agreements allowed the accused infringer to sell a quantity of goods without Exxon’s quality control (and hence, the defendant asserted, constituted naked licenses), in the long term such agreements worked to maintain Exxon’s exclusivity in the mark by removing third parties from the marketplace. As the Fifth Circuit observed, “We, like the district court, would find it wholly anomalous to presume a loss of trademark significance merely because Exxon, in the course of diligently protecting its mark, entered into agreements designed to preserve the distinctiveness and strength of that mark.”81

Covenants not to sue are plainly quite different from the phase-out agreements approved by the Fifth Circuit in Exxon. Phase-out agreements by definition require the infringer to cease using the mark after a certain point, generally when current inventory is exhausted. While in the short term a phase-out agreement permits a small amount of product to be sold without the trademark owner’s quality control, in the long run a phase-out agreement preserves the trademark owner’s exclusivity in use of that mark for those goods. In sharp contrast, covenants not to sue expressly permit the infringer to continue selling infringing goods for an unlimited time in unlimited quantities. They therefore undermine the perception of the trademark owner as the sole source of goods bearing that mark.

79. See id. at 1080.

80. Indeed, the Fifth Circuit compared the naked licensing defense to a failure to enforce, discussed above, which is generally relevant only to ascertaining the “strength of the mark.” See id.

81. Id. (emphasis in original).
b. The “Control” Theory of Naked Licensing

More fundamentally, the Fifth Circuit’s equation of the statutory phrase “lose its significance as a mark” as connoting only loss of commercial distinctiveness is questionable. It appears that other courts understand the statutory language to mean, rather, loss of legal significance as a trademark. A review of the history of the law of trademark licensing should make this point clear.

In the early twentieth century, courts held that because a trademark was a mere symbol of good will, it was legally impossible to license a trademark at all.83 Beginning in the mid-twentieth century, courts permitted licensing, but only if adequate quality control by the trademark owner was put in place:

The narrow conception of trademarks as indications of physical source was eventually replaced by recognition that trademarks may signify other connections between goods bearing the mark and the trademark owner, including the trademark owner’s approval or sponsorship of the goods. The “source” identified by a trademark may now be a distributor, retailer, or other entity that selects the goods on which the mark appears. Trademarks thus came to be understood as indications of consistent and predictable quality assured through the trademark owner’s control over the use of the designation. Emphasis on the quality assurance function of trademarks led modern courts to uphold the validity of trademark licenses when the control retained by the licensor was sufficient under the circumstances to insure that the licensee’s goods or services would meet the expectations created by the presence of the trademark.84

Naked licensing severs this control connection:

An uncontrolled or “naked” license allows use of the trademark on goods or services for which the trademark owner cannot offer a meaningful assurance of quality. When a trademark owner fails to exercise reasonable control over the use of the mark by a licensee, the presence of the mark on the licensee’s goods or services misrepresents their connection with the trademark owner since the mark no longer identifies goods or services that are under the control of the owner of the mark. Although prospective purchasers may continue to perceive the designation as a trademark, the courts have traditionally treated an erosion of the designation’s capacity for accurate identification resulting from uncontrolled

83. See Restatement (Third) of Unfair Competition § 33 cmt. a (1995).
84. Id.
licensing as a loss of trademark significance, thus subjecting
the owner of the mark to a claim of abandonment under the
rule stated in [Restatement (Third) of Unfair Competition]
§ 30(2)(b).85

Thus, a mark that has been the subject of a “naked license”
has, in effect, lost any connection to the trademark owner, which is
now neither the producer nor the quality controller of the goods or
services. The mark no longer can signify that the goods have a
connection to the trademark owner—the owner has relinquished
such control.86

It can be argued (and trademark owners should expect
defendants to argue) that such severing of the connection to the
trademark owner results in the loss of “significance as a mark,”
even if, in the public’s perception, the mark remains commercially
strong.

c. Deceptive Use

Finally, trademark owners should anticipate that an
argument rejected by the Fifth Circuit in Exxon will be raised in
other venues. The Lanham Act provides that a registration (even
an incontestable one) can be canceled if “the registered mark is
being used, by or with the permission of the registrant or a person
in privity with the registrant, so as to misrepresent the source of
the goods or services on or in connection with which the mark is
used.”87 The Fifth Circuit rejected reliance on this subsection as
the statutory basis to sustain a naked-licensing defense,88 holding
that the case law indicated that such a defense (implicit in the
grounds for cancellation) was available only where “the origin or
source of goods distributed under the subject mark is
misrepresented.”89 But that is precisely the evil of naked
licensing—and other courts of appeals have expressly condemned
it in those very terms, labeling it a deception or fraud on the
public.90

For all these reasons, a trade mark owner that proffers a
covenant not to sue runs the risk not only that it will be construed

85. Id. cmt. b.
86. See Eva’s Bridal, 639 F.3d at 790-91 (endorsing such a “control” theory of naked
licensing).
88. Exxon Corp. v. Oxxford Clothes, Inc., 109 F.3d 1070, 1078 n.11 (5th Cir. 1997).
89. Id.
90. See 3 McCarthy, supra note 58, § 18:48 nn.1, 4 (collecting cases). Cf. Dawn Donut
Co. v. Harts Food Stores, Inc., 267 F.2d 358, 367 (2d Cir. 1959) (“[U]nless the [trademark]
licensor exercises supervision and control over the operations of its licensees the risk that
the public will be unwittingly deceived will be increased and this is precisely what the Act is
in part designed to prevent.”).
as a naked license but also that it may result in loss of trademark rights.

D. Consent to Use Agreements

A third type of agreement recognized under trademark law is a “consent to use” agreement, also known as a coexistence agreement. In such an agreement, one party, the trademark owner, consents to the other party’s use of the trademark within defined boundaries and promises not to sue so long as the use is kept within the defined boundaries. The boundaries may consist of certain formats of the mark, certain geographical territories, or certain lines of goods and services.91 Such agreements are commonly used in settling disputes over trademark usage.92

It is doubtful that a covenant not to sue constitutes such a coexistence agreement. The basic difference between a license and a consent agreement is that the former authorizes activities that would otherwise be infringing (and hence requires quality control provisions), whereas the latter defines certain activities for each of the parties that by definition would not infringe the other party’s rights.93

Covenants not to sue that typically are proffered in the midst of infringement litigation do not seem to qualify as coexistence agreements. First, the trademark owner generally insists that it is not conceding the non-infringing nature of the defendant’s goods. Second, the trademark owner retains the right both to use the scope of the mark within the covenant on additional goods and to sue third parties for such uses. (To illustrate using the Nike covenant, Nike, as trademark owner, clearly planned to continue selling sneakers bearing its registered design and to sue third parties for infringement of that design.) Third, in the usual situation as reported by the cases, the defendant is not consenting to anything—the covenant is instead being forced upon it as a means to moot the lawsuit and avoid a judicial determination of the validity of the intellectual property rights at issue. In short, covenants not to sue lack the basic characteristics of a coexistence agreement: mutual consent to carve out trademark rights in distinct areas, each of the parties to have its own rights in its own area, and each agreeing that the other’s exercise of its rights does not infringe its own.

91. 3 McCarthy, supra note 58, § 18:79.
92. Id.
93. Id. See also Exxon, 109 F.3d at 1076 (noting that a consent to use agreement “[i]s not an attempt to transfer or license the use of a trademark . . . but fixes and defines the existing trademark of each . . . [so] that confusion and infringement may be prevented” and adding that the definitive test between the two is whether the subject goods would or would not infringe the owner’s mark).
Conceivably, a trademark owner might argue that a covenant not to sue contains a “format” restriction in that it covers only designs that the defendant had already created or marketed, not new designs it might create in the future (which might be closer to the mark than those offered in the past). It appears that Nike attempted to preserve just such an argument in the litigation before the Second Circuit, which noted:

To be sure, the Covenant has not made future litigation between the parties impossible: at oral argument on appeal, counsel for Nike acknowledged that if [the defendant] were to manufacture an exact copy of the Air Force 1 shoe (which presumably would include not only Nike’s claimed trade dress, but also its trademark), Nike could claim that the Covenant permits an infringement suit on the ground that a counterfeit differs from a colorable imitation under the Lanham Act.94

It thus appears that Nike tried to reserve to itself the argument that a future, new design marketed by the defendant would not be merely a “colorable imitation” but rather a much closer copied “counterfeit,” and not within the covenant. The problem with that argument is that (1) colorable imitations can be infringing if they cause confusion,95 as indeed Nike itself charged in that very suit, and (2) the Second Circuit itself remarked how close Nike’s registered mark was to the accused items.96 Clearly, a covenant not to sue tolerates some range of infringement, and accordingly it is difficult to construe it as a consent to use agreement, which is supposed to define areas of non-infringement.

E. Effect of a Consent to Use Agreement

Even if some covenants not to sue were to be construed as a consent to use agreement, that does not mean the trademark owner’s rights are unaffected. As was discussed above, a consent to use agreement is an attempt to define areas where one party’s use of a mark can coexist with another’s without creating consumer confusion. Where a party to such an agreement then attempts to enforce its rights against third parties, the consent to use agreement often will be taken as an admission that there is no confusion within the parameters of the agreement—and such an admission may spill over to later enforcement efforts.97

94. Nike, Inc. v. Already, LLC, 663 F.3d 89, 97 n.5 (2d Cir. 2011), cert. granted, 80 U.S.L.W. 3480 (U.S. June 25, 2012) (No. 11-982)
96. See Nike, 663 F.3d at 97 (“Given the similarity of [the defendant’s] designs to the [registered] mark and the breadth of the Covenant, it is hard to imagine a scenario that would potentially infringe the . . . mark and yet not fall under the Covenant.”).
97. See 3 McCarthy, supra note 58, § 18:81.
An early example of this effect can be seen in the Seventh Circuit’s decision in a 1947 case, *California Fruit Growers Exchange v. Sunkist Baking Co.* There, one party had been using the mark SUNKIST on citrus fruit and the other had used the mark SUN-KIST on canned fruit and vegetables. They entered into an agreement consenting to their respective uses. Both parties later filed suit as joint plaintiffs against a bakery that was using the mark SUNKIST on bread. The Seventh Circuit relied on the consent agreement to support its finding of no likely confusion. Because the plaintiffs by contract had agreed that there would be no confusion as a result of the use of the same mark on their respective products, they were precluded from later claiming that there would be confusion from the defendant’s use of the mark on bread:

[Plaintiffs’] cry that there is a likelihood of confusion of the source of a loaf of bread put out by a local bakery . . . with their products because they market fruits and vegetables under the same name . . . is hardly audible to us. . . . We are supposed to believe that when a customer bought fruits or vegetables under the name “Sunkist,” he was not confused as to whether the fruit came from the California Fruit Growers Exchange or the vegetables from the California Packing Corporation; but if he bought a loaf of bread under the name “Sunkist,” he was likely to think that he bought it from one or the other of the plaintiffs because they sold fruits and vegetables, but never bread. With the plaintiffs practicing such hocus-pocus with the trade-name “Sunkist,” we shall ask to be excused when we are admonished by these dividers of confusion by contract to hear their vice president and advertising manager shout confusion on behalf of the purchasing public.

Note how a third party—the defendant bakery—was able to rely on the plaintiffs’ agreement—an agreement to which it was a stranger—to defeat a trademark claim.

More recently, in *Universal City Studios, Inc. v. Nintendo Co.*, the plaintiff asserted ownership of rights in the King Kong character and concept, which it claimed functioned as a trademark and which it further claimed was infringed by the defendant’s video game Donkey Kong. The plaintiff sued not only Nintendo, the game manufacturer, but also Nintendo’s licensees, including Atari and Coleco. Universal eventually settled its claims against these licensees for payment of several millions of dollars in

98. 166 F.2d 971 (7th Cir. 1947).
99. Id. at 975.
100. 578 F. Supp. 911 (S.D.N.Y. 1983), aff’d on other grounds, 746 F.2d 112 (2d Cir. 1984).
royalties. The settlement included a covenant not to sue that
allowed the Nintendo licensees to continue to distribute and
exploit the Donkey Kong franchise in various media—all without
any quality control by Universal.\textsuperscript{101}

The court held that it did not have to decide (as Nintendo
argued) whether these covenants not to sue constituted naked
licenses (which would lead to an abandonment of the mark) or
were admissions that use of Donkey Kong game concepts for video
games by the Nintendo licensees (and hence, also, by Nintendo
itself) would not lead to consumer confusion.\textsuperscript{102} Either way, the
covenants supported the conclusion that there was no valid
trademark claim, and that led to dismissal of the infringement
claims against Nintendo.\textsuperscript{103}

Applying this law to covenants not to sue proffered in
litigation, even if they are not construed as naked licenses, they
should at a minimum function as an admission or estoppel that
any designs that to the date of the covenant have been marketed
by the defendant are not confusingly similar to the plaintiff’s
mark. To illustrate using the Nike example, future infringers,
whether the defendant or others, have a strong basis to argue that
any shoe design that is within the covenant—which by its terms
includes the designs already marketed by the defendant and any
colorable imitation thereof—does not cause consumer confusion,
and Nike cannot enforce its rights against such designs, even if
marketed by third parties. Whether this leaves any scope to the
mark at all can be determined only by examining the mark, the
language of the covenant, and the designs that were the subject of
the lawsuit.

V. SUMMARY AND CONCLUSION

Intellectual property owners have used a proffer of a covenant
not to sue the defendant to extricate themselves from litigation
they no longer wish to pursue. The Supreme Court will soon
resolve the jurisdictional question of whether such a proffer is
effective to moot the case—or, more specifically, how broadly such
a covenant must be formulated.

However, unlike copyright and patent owners, trademark
plaintiffs should be concerned that the proffered covenant will
affect not only the future acts of the defendant but the validity
itself of the trademarks or trade dress asserted in the suit. A
powerful argument can be made that almost any covenant not to
sue that is sufficiently broad to moot the case may also be
construed (indeed, we believe it will likely be construed) as either a

\textsuperscript{101.} Id. at 918.
\textsuperscript{102.} See id. at 929-30.
\textsuperscript{103.} See id.
naked license or an admission that there is no confusion from any uses of the trademark covered by the covenant. This likely will negatively affect the trademark owner's ability to enforce the mark against others.

In our view, a trademark owner should assume that, at least to the scope of the covenant, it may no longer be able to enforce its trademark rights against anyone, not only the defendant in suit. Of course, proffering a covenant not to sue in any type of case is a trade-off that the plaintiff must carefully evaluate. Trademark owners and their counsel should appreciate, however, that the cost side of that balance may weigh more heavily in such cases than in patent or copyright cases.
APPENDIX

Covenant Not to Sue from the Nike Case

COVENANT NOT TO SUE

This Covenant Not to Sue ("Covenant") is made by NIKE, Inc., an Oregon corporation having a principal place of business at One Bowerman Drive, Beaverton, Oregon 97005 ("NIKE"), and is effective as of March 17, 2010 ("Effective Date").

RECITALS

WHEREAS, on July 16, 2009, NIKE commenced civil action number 09-CV-6366 against Already, LLC, a Texas limited liability company, with a principal place of business at 3501 State Highway 157, Suite 101, Euless, Texas 76040 ("Already"), in the United States District Court for the Southern District of New York (the "Complaint") asserting claims for (a) trademark infringement under Section 32(1) of the Lanham Act, (b) false designation of origin/unfair competition under Section 43(a) of the Lanham Act, (c) dilution under Section 43(c) of the Lanham Act, (d) trademark infringement and unfair competition under the common law, and (e) dilution under Section 360 of the New York General Business Law, all in relation to the NIKE Mark (defined below);

WHEREAS, NIKE represents and warrants that it owns federal and common law trademark rights in the design of NIKE’s Air Force 1 low shoe, including United States Trademark Registration Number 3,451,905, registered June 24, 2008, collectively hereafter referred to as the "NIKE Mark;"

WHEREAS, NIKE has recently learned that Already’s actions complained of in the Complaint no longer infringe or dilute the NIKE Mark at a level sufficient to warrant the substantial time and expense of continued litigation and NIKE wishes to conserve resources relating to its enforcement of the NIKE Mark; and

NOW, THEREFORE, NIKE covenants as follows:

COVENANT

NIKE for and on behalf of itself, its parents, subsidiaries, divisions, related companies, affiliated companies, licensees, independent contract manufacturers, assigns, and/or other related business entities, as well as any of their predecessors, successors, directors, officers, employees, agents, distributors, attorneys, representatives, and employees of such entities, hereby unconditionally and irrevocably covenants to refrain from making any claim(s) or demand(s), or from commencing, causing, or permitting to be prosecuted any action in law or equity, against Already or any of its parents, subsidiaries, divisions, related companies, affiliated companies, licensees, independent contract manufacturers, assigns, and/or other related business entities, as well as any of their predecessors, successors, directors, officers, employees, agents, distributors, attorneys, representatives, and employees of such entities and all customers of each of the foregoing (whether direct or indirect), on account of any possible cause of action based on or involving trademark infringement, unfair competition, or dilution, under state or federal law in the United States relating to the NIKE Mark based on the appearance of any of Already’s current and/or previous footwear product designs, and any colorable imitations thereof, regardless of
whether that footwear is produced, distributed, offered for sale, advertised, sold, or otherwise used in commerce before or after the Effective Date of this Covenant.

By: Julianne Davis, Esq.
Title: Assistant General Counsel
NIKE, Inc.