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Supreme Court Tackles Extent of Federal Subject-Matter Jurisdiction Over Compulsory Counterclaims in Cases Presenting Abandoned Claims

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On June 25, 2012, the United States Supreme Court granted a petition for certiorari in *Nike, Inc. v. Already, LLC*, 663 F.3d 89 (2d Cir. 2011). The petition raises the issue of whether a plaintiff, who, for whatever reason, does not want to continue with a lawsuit in federal court (e.g., the case is going poorly or is over budget, there is an absence of concern about defendant's conduct going forward, etc.), can provide a covenant not to sue to the defendant and thereby preempt the court from hearing any counterclaims as to the validity of the mark. In other words, once a defendant has contested a case, must the plaintiff continue to defend its trademark (or patent, copyright, etc.) at its peril even after it has abandoned its own affirmative claims? The Court's answer could resolve an issue left open since *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007), loosened the standard for determining when an actionable case and controversy exists for purposes of federal subject-matter jurisdiction.

The plaintiff in *Nike* prosecuted a suit to protect a federally registered trademark consisting of a product design for approximately eight months, while the defendant pursued compulsory counterclaims brought under Section 37 of the Lanham Act, 15 U.S.C. § 1119, to invalidate the plaintiff's mark and to cancel the various registrations covering it. The plaintiff then presented the defendant with a "covenant not to sue," which recited, among other things, that the plaintiff had "recently learned that [the defendant's] actions complained of in the Complaint no longer infringe or dilute [the plaintiff's mark] at a level sufficient to warrant the substantial time and expense of continued litigation and [the plaintiff] wishes to conserve resources relating to its enforcement of the [mark]." *Quoted in id.* at 92. The covenant also obligated the plaintiff

to refrain from making any claim(s) or demand(s) or from commencing, causing, or permitting to be prosecuted any action in law or in equity, against [the defendant] or any of its [successors or related entities and their customers], on account of any possible cause of action based on or involving trademark infringement, unfair competition, or dilution under state or federal law.

Quoted in id. (second alteration in original).

The federal district court hearing the action dismissed the defendant's counterclaims, and the Second Circuit affirmed. According to the appellate court:

In determining whether a covenant not to sue eliminates a case and controversy in a declaratory judgment action involving a trademark, district courts applying the *MedImmune* totality of the circumstances test should especially consider, in addition to other factors: (1) the language of the covenant, (2) whether the covenant covers future, as well as past, activity and products, and (3) evidence of intention or lack of intention, on

the part of the party asserting jurisdiction, to engage in new activity or to develop new potentially infringing products that arguably are not covered by the covenant.

Id. at 96 (footnote omitted).

Reviewing the covenant against this doctrinal backdrop, the court concluded that the defendant's counterclaims properly had been dismissed. To begin with, "[t]he language of the covenant is broad, covering both present and future products . . ." *Id.* This unconditional and permanent renunciation of the plaintiff's claims, the court held, "renders the threat of litigation remote or nonexistent even if [the defendant] continues to market and sell [the goods accused of violating the plaintiff's rights] or significantly increases their production." *Id.* at 97. Indeed, "[g]iven the similarity of the [the defendant's goods] to the [plaintiff's registered mark] and the breadth of the Covenant, it is hard to imagine a scenario that would potentially infringe the . . . mark and not yet fall under the covenant." *Id.* As an additional matter, the court rejected the defendant's argument that dismissal was inappropriate because an inability to defend itself against the ongoing *de minimis* infringement alleged in the covenant would cause potential investors to direct their capital elsewhere: "In this case, potential investor concerns about infringement lawsuits against the company, despite [the plaintiff's] broad Covenant, fail to establish the sort of genuinely adverse legal interests between [the parties] that *MedImmune* requires." *Id.* Ultimately, therefore, "a claim for trademark [registration] cancellation . . . is insufficient to support federal jurisdiction where a covenant not to sue has resolved the underlying infringement action." *Id.* at 99.

In reaching this conclusion, the Second Circuit expressly rejected what appeared to be a directly conflicting holding by the Ninth Circuit's pre-*MedImmune* opinion in *Bancroft & Masters, Inc. v. Augusta National Inc.*, 223 F.3d 1082 (9th Cir. 2000). *Bancroft & Masters*, a declaratory judgment action triggered by the defendant's objections to the plaintiff's domain name, involved a proposed covenant similar to that in *Nike*, but one that the Ninth Circuit concluded was sufficiently ambiguous that it did not necessarily bar the defendant from reasserting its claims later. See *id.* at 1085 ("[The plaintiff's] request for a declaratory judgment that it is entitled to use the domain name is not moot, however, because [the defendant] has not made the requisite showing that it is absolutely clear that it will never seek to prevent [the plaintiff] from using its domain name in the future."). That ambiguity did not stop the Ninth Circuit from concluding that a federal court may retain jurisdiction over a counterclaim for cancellation notwithstanding the end of a case or controversy with respect to the rest of the action. See *id.* (observing that that even an unqualified promise not to sue "would not have mooted [the] separate request for cancellation of [the] trademark[] [registrations]"). The ambiguity did, however, allow the Second Circuit to dismiss the Ninth Circuit's determination as mere dictum. See *Nike*, 663 F.3d at 99. The Second Circuit also faulted the Ninth Circuit for treating Section 37 of the Lanham Act as jurisdictional, rather than remedial. See *Nike*, 663 F.2d at 99.

Although on its face the petition for certiorari in *Nike* is limited to actions in which the validity of a trademark is in dispute, there is no readily apparent reason why the question presented by the petition does not have equal relevance to patent, copyright, and trade secret claims. Indeed, the petition arguably bears on *any* scenario in which a plaintiff chooses to withdraw its claims rather than risk losing on the merits of a compulsory counterclaim. The Court's resolution of the question presented therefore promises to have effects beyond the case in which it has been raised.

For more information about these issues, please contact the author(s) of this Legal Alert or your existing firm contact.

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