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Already and *Kirtsaeng*: Lessons for Prospective Intellectual Property Enforcement

by Theodore K. Cheng

Last term, the Supreme Court again issued decisions with far-reaching implications for intellectual property practitioners, owners, and users. Two cases from the Second Circuit afforded particularly important insights and lessons for prospective intellectual property enforcement. *Already, LLC v. Nike, Inc.*[1] provided practical guidance for using covenants not to sue in enforcing trademark portfolios. *Kirtsaeng v. John Wiley & Sons, Inc.*[2] validated the "gray market" for copyrighted works[3] and effectively recognized international copyright exhaustion.[4] This article offers some practical observations for practitioners, owners, and users of intellectual property.

Already v. Nike: Divesting Federal Courts of Jurisdiction Using Covenants Not to Sue

This dispute involved two manufacturers of athletic footwear—Nike, Inc. and Already, LLC. Nike designs, develops, markets, and sells a variety of athletic accessories and services. Specifically, it sells the popular line of athletic footwear under the "Air Force 1s" brand, which

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[1] 133 S. Ct. 721 (2013).

[2] 133 S. Ct. 1351 (2013).

[3] The "gray market" generally refers to the trading in goods outside of the normal established distribution system established by the manufacturer. One of the most common gray markets is the importation and sale of goods through unauthorized importers and sellers in a particular geographic region, replacing the typically more expensive distribution system established by the manufacturer. Thus, while sales through the gray market are intended to be legal, they are unofficial, unauthorized, and unintended by the manufacturer.

[4] International copyright exhaustion means that the first sale of a copyrighted work, whether manufactured domestically or overseas, is sufficient to "exhaust" the copyright owner's rights to that work, such that the buyer of that particular copy (and any subsequent owners of that copy) may freely dispose of it.

Nike produces in more than 1,700 color combinations, selling millions of pairs each year. Nike owns several federal trademark registrations for that brand, including one that protects various design elements.[5]

In July 2009, after an unsuccessful cease-and-desist letter, Nike commenced litigation against Already.[6] Nike alleged that Already was selling "'footwear bearing a confusingly similar imitation'" of the Air Force 1 shoe, including shoes known as "Sugar" and "Soulja Boy."[7] Four months later, Already filed counterclaims for a declaratory judgment that Nike's mark was invalid for not being a "trademark" under either federal or state law and sought its cancellation.[8]

In March 2010, Nike sent Already a "Covenant Not to Sue," stating in the preamble that it had "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."[9] The covenant thereafter obligated Nike:

> 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 [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 in the United Sates [*sic*] 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,

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[5] *See Nike, Inc. v. Already, LLC*, 663 F.3d 89, 92 (2d Cir. 2011).

[6] *See id.* at 91.

[7] *Id.* at 92 (quoting complaint).

[8] *See id.*

[9] *Id.*

> advertised, sold, or otherwise used in commerce before or after the Effective Date of this Covenant.[10]

After issuing the covenant, Nike voluntarily moved to dismiss its claims and also moved to dismiss Already's counterclaims on the ground that the covenant had extinguished the case or controversy. But in Already's view, the counterclaims created an independent controversy about whether Nike had violated Already's rights by improperly obtaining a trademark registration.[11] The District Court not only dismissed Nike's claims, but also dismissed Already's counterclaims, determining that it no longer possessed jurisdiction over them.[12]

The Second Circuit affirmed.[13] Applying the totality of the circumstances test from *MedImmune, Inc. v. Genentech, Inc.*[14] for the first time in an intellectual property case,[15] the panel opined that courts should consider three factors when determining whether a covenant not to sue eliminates a case or controversy in a declaratory judgment action involving a trademark:

> (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

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[10] *Id.*

[11] *See id.* at 93.

[12] *See id.*

[13] *See id.* at 94-99.

[14] 549 U.S. 118, 126-27, 137 (2007) (confirming that the totality of the circumstances test for declaratory judgment actions should be applied in intellectual property cases and holding that the "actual controversy" requirement of the Declaratory Judgment Act does not require that a patent licensee terminate or breach the agreement by refusing to pay royalties before suing to declare a patent invalid and enforceable).

[15] *See Nike*, 663 F.3d at 96.

> develop new potentially infringing products that arguably are not covered by the covenant.[16]

Utilizing these factors, the court held that there was no case or controversy.[17]

In its unanimous opinion affirming the Second Circuit, the Supreme Court began its analysis by noting that both parties had standing to pursue their claims in court: Nike claimed that Already was allegedly infringing its trademark rights, and Already accused Nike of allegedly using an invalid mark to stop legitimate business activity.[18] However, when Nike dismissed its claims with prejudice and issued the covenant, it "call[ed] into question the existence of any continuing case or controversy."[19] Thus, under the "voluntary cessation" doctrine, Nike bore the "burden to show that it could not reasonably be expected to resume its enforcement efforts against Already."[20] Analyzing the plain language of the covenant, the Court concluded that its breadth sufficiently met that burden, noting, in particular, the fact that it was "unconditional and irrevocable" and barred "Nike from making any claim *or* any demand."[21]

Moreover, the covenant stretched beyond Already to protect Already's distributors and customers, and it covered not just current or previous designs, but any "colorable imitations," including the Sugars and Soulja Boys, which Nike had contended infringed its trademark and,

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[16] *Id.* (footnotes omitted).

[17] *See id.* at 97-99.

[18] *Already*, 133 S. Ct. at 727.

[19] *Id.*

[20] *Id.* (internal quotation marks omitted).

[21] *Id.* at 728 (emphasis in original).

thus, were "colorable imitations" of Air Force 1s.[22] Accordingly, the Court agreed with the Second Circuit that "'it is hard to imagine a scenario that would potentially infringe [Nike's trademark] and yet not fall under the Covenant.'"[23] Therefore, it opined that, "[i]f such a shoe exists, the parties have not pointed to it, there is no evidence that Already 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."[24]

***Already*'s Impact on the Strategic Use of Covenants Not to Sue**

The outcome in *Already* was not surprising, given the Court's Article III jurisprudence. But the decision's importance to trademark enforcement strategies bears emphasizing.

From the mark owner's perspective, sending a cease-and-desist letter or commencing a litigation always entails the risk of the alleged infringer interposing a declaratory judgment claim and miring the owner in a battle over the mark's validity. *Already* now gives the owner more procedural control by providing the tools to successfully dismiss the declaratory relief claim through the issuance of a broad covenant not to sue.

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[22] *Id.*

[23] *Id.* (quoting *Nike*, 663 F.3d at 97).

[24] *Id.* The Court further noted that, given the opportunity before the District Court to assert any intent to design or market a shoe that would fall outside of the Covenant, Already failed to do so. *See id.* at 728-29. The Court also rejected Already's attempt to assert various alternative theories of Article III injury to save the case from being moot, namely, that (1) so long as Nike remains free to assert its trademark, investors will be apprehensive about investing in Already; (2) given Nike's decision to sue, Nike's trademarks will now oppressively hang over Already's operations; and (3) as one of Nike's competitors, Already inherently has standing to challenge Nike's intellectual property. *See id.* at 729-32. Finally, the Court rejected the U.S. Solicitor General's suggestion that the case be remanded for further proceedings, concluding that "such a remand would serve no purpose" in view of the fact that the "[t]he scope of the covenant is clear." *See id.* at 732-33.

Under *Already*, the mark owner continues to bear the burden of demonstrating mootness, and whether such a covenant will divest the court of jurisdiction will depend upon its breadth. In the trademark context, the *Already* Court identified the following five characteristics:

(1) be unconditional and irrevocable;
(2) cover the alleged infringer and related entities (e.g., distributors and customers);
(3) cover all current and previous products;
(4) cover all "colorable imitations" of any current and previous products; and
(5) bar the mark owner from making any future claims or demands with respect to the mark-at-issue.

In short, the covenant should render the threat of future litigation between the same parties (and related entities) on the same trademark remote, "inconceivable," or "unimaginable."

Certainly, the decision to issue a covenant not to sue must be balanced against the risk that a court will deem the covenant too narrow to dismiss the invalidity claim. Also significant is how such a covenant will be viewed in future enforcement efforts concerning that same mark against other alleged infringers. Successive issuances of broad covenants not to sue might result in the slow erosion of trademark rights such that the mark may be difficult to enforce against parties not covered by the covenants.

Additionally, the Court's opinion opened the door to possible abuse by mark owners, who could charge competitors with infringement, knowing that a covenant not to sue would allow them to abandon the suit. As Justice Kennedy warned in his concurring opinion, the pendency of a lawsuit itself can dissuade the marketplace from dealing with the alleged infringer.[25] It remains to be seen how this concern will influence courts if mark owners increasingly embark upon aggressive campaigns to enforce their marks, relying on the

[25] *See id.* at 733-34 (Kennedy, J., concurring).

availability of covenants not to sue to terminate the litigations early. Congress has not been particularly shy in the trademark arena,[26] and, thus, such conduct could spur the enactment of (at least from the mark owners' perspective) unwanted negative legislative action.

The lesson from the alleged infringers' perspective is that, if they desire to maintain their challenge to the mark's validity and seek its cancellation, unlike Already, they must come forward and explicitly set forth an intention to infringe. Doing so will make the mark owner think twice about issuing a covenant not to sue and compel it to defend the mark.

Finally, practitioners, owners, and users should all be on the lookout for how the Court's Article III case and controversy analysis will impact the jurisprudence in patent and copyright declaratory judgment litigations. The lessons from *Already* will surely have ramifications in those fields as well.[27]

***Kirtsaeng v. John Wiley*: Validating the Gray Market for Copyrighted Works**

Under § 106 of the Copyright Act, a copyright owner has certain "exclusive rights," including the right "to distribute copies . . . of the copyrighted work to the public by sale or other transfer of the ownership."[28] These rights are circumscribed by other sections of the Act,[29]

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[26] The Lanham (Trademark) Act of 1946, 15 U.S.C. § 1051 *et seq.*, has been amended over thirty times since its enactment.

[27] *See, e.g.*, *Organic Seed Growers & Trade Ass'n v. Monsanto Co.*, 718 F.3d 1350, 1357-58 (Fed. Cir. 2013) (dismissing a patent declaratory judgment action under *Already* that involved "binding assurances" as opposed to covenants not to sue); *Perfect-Vision Mfg., Inc. v. PPC Broadband, Inc.*, No. 4:12CV00623 JLH, 2013 U.S. Dist. LEXIS 81011, at *20-23 (E.D. Ark. Jun. 10, 2013) (denying motion to dismiss a patent declaratory judgment action after issuance of a covenant not to sue by the defendant because, unlike in *Already*, the covenant was "not unconditional and irrevocable").

[28] 17 U.S.C. § 106(3).

[29] *Id.* §§ 107-22.

including § 109(a)—also known as the first sale doctrine—which states, in pertinent part, that "the owner of a particular copy or phonorecord lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."[30] Thus, even though a copyright owner has the right to prohibit distribution of copies of the work without permission, once a copy has been lawfully sold, the buyer of that particular copy (and any subsequent owners of that copy) may freely dispose of it.

That analysis is not straightforward when copyrighted works cross national boundaries. Under § 602(a)(1) of the Act, if the copy in question was purchased overseas with the copyright owner's permission, the buyer seemingly may not thereafter import that copy without permission from the copyright owner.[31] However, in 1998, the Supreme Court interpreted the interplay between § 602(a)(1) and § 109(a), unanimously holding the first sale doctrine applicable to imported copies and, consequently, concluding that a copy bought overseas can, in fact, freely be imported into the United States and disposed of without the copyright owner's permission.[32] Notably, there, the copy, although purchased overseas, had initially been manufactured in the United States, and, thus, had experienced a "'round-trip' journey."[33] *Kirtsaeng* addressed the open question of copies that are first made overseas. In a 6-3 decision, the Court held the first sale doctrine applicable to copies of a copyrighted work first made overseas, thereby permitting

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[30] *Id.* § 109(a).

[31] *See id.* § 602(a)(1) ("Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501.").

[32] *See Quality King Distrib., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 140-54 (1998).

[33] *Id.* at 154 (Ginsburg, J., concurring).

their importation into the United States without the copyright owner's permission[34] and effectively recognizing international copyright exhaustion.[35]

The alleged infringer, Supap Kirtsaeng, a citizen of Thailand, had moved to the U.S. to study mathematics.[36] While here, he asked his friends and family in Thailand to purchase copies of foreign edition English-language textbooks, where they could be bought at low prices, and ship them to the U.S. for resale at a profit.[37] The publisher of the foreign edition textbooks, John Wiley & Sons, Inc., sold equivalent versions of the same textbooks in the U.S. and filed suit against Kirtsaeng, claiming that his unauthorized importation and later resale amounted to an infringement of its distribution right, as well as the importation prohibition.[38] In defense, Kirtsaeng asserted that, because he had acquired the foreign edition textbooks legitimately in Thailand, they were "lawfully made" under the Act, and, thus, the first sale doctrine permitted him to resell or otherwise dispose of the books without any further permission from Wiley. According to Wiley, however, "lawfully made under this title" geographically limited that doctrine's application to copies actually made in the United States.[39]

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[34] *See* 133 S. Ct. at 1355.

[35] *See id.* at 1371 (characterizing the respondent's argument as describing its decision as "launch[ing] United States copyright law into an unprecedented regime of 'international exhaustion'").

[36] *See id.* at 1356.

[37] *See id.*

[38] *See id.* at 1356-57.

[39] *See id.* at 1357.

The District Court rejected Kirtsaeng's first sale defense, holding that it did not apply to "foreign-manufactured goods," after which a jury found that Kirtsaeng had willfully infringed eight of Wiley's copyrighted titles, assessing statutory damages of $600,000 ($75,000 per work). The Second Circuit, in a split decision, affirmed, with the majority adopting Wiley's reading of § 109(a). Reversing the appellate court, the Supreme Court held that "§109(a)'s language, its context, and the common-law history of the 'first sale' doctrine, taken together, favor a non-geographical interpretation."[40] The Court relied, in part, on the "parade of horribles" that *amici* associations of libraries, used-book dealers, technology companies, consumer-goods retailers, and museums had presented,[41] noting, "We also doubt that Congress would have intended to create the practical copyright-related harms with which a geographical interpretation would threaten ordinary scholarly, artistic, commercial, and consumer activities."[42]

In rejecting the geographical interpretation,[43] the Court notably conceded that its interpretation "will make it difficult, perhaps impossible, for publishers (and other copyright

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[40] *Id.* at 1358. *See also id.* at 1358-64.

[41] *See id.* at 1364-67. For example, a geographical interpretation could mean that U.S. retailers, businesses, and buyers of copyrighted works manufactured abroad would need to track down copyright owners and obtain authorization before reselling or even giving away copies. A geographical interpretation could also prevent resale of goods (e.g., cars or mobile phones) without the owner's permission on every copyrighted piece or component of that good (e.g., software). Libraries, museums, charitable organizations, and non-profit entities could also have to take steps to obtain necessary licensing rights for goods that they import and distribute.

[42] *Id.* at 1358.

[43] *See id.* at 1367-71.

holders) to divide foreign and domestic markets."[44] But it then dismissed that concern because it could also "find no basic principle of copyright law that suggests that publishers are especially entitled to such rights."[45] Consequently, the first sale doctrine now applies to works first made abroad and later imported and resold.

***Kirtsaeng*'s Exhaustion Requirement on Copyright Industries**

Unlike in *Already*, the outcome in *Kirtsaeng* was far from expected. The Second Circuit, Ninth Circuit, and the Solicitor General all advocated a geographical interpretation, and the U.S. has long opposed international exhaustion in global trade negotiations.[46] The Court's decision, however, arguably marks an end to overt price discrimination across national boundaries, at least in the publishing industry, by U.S. copyright owners.

Of course, alternate ways to continue engaging in price discrimination and market segmentation exist. For example, publishers can create different books for the U.S. and foreign markets, or alter the foreign editions of the works sufficiently so that they are less useful in this country (e.g., different ordering, pagination, or illustrations). They can also contractually bar foreign wholesalers from importing into the U.S., thereby obviating the exhaustion issue altogether. Relatedly, they can restrict the amount of sales in foreign countries to match local demand, thereby curtailing gray market sales of the works.

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[44] *Id.* at 1370. *See also id.* at 1371 ("[T]he Constitution's language nowhere suggests that its limited exclusive right should include a right to divide markets or a concomitant right to charge different purchasers different prices for the same book, say to increase or to maximize gain.").

[45] *Id.* at 1370.

[46] The U.S. has long opposed international exhaustion because it can make territory-based pricing and distribution policies impractical.

In the near-term, American consumers may be able to purchase less expensive foreign editions of books at lower prices. Until the marketplace adjusts to the new regime put in place by the Supreme Court—and unless Congress steps in otherwise—entrepreneurs ranging from individuals like Kirtsaeng to retailers like Costco will likely find it profitable to engage in cross-border arbitrage without the fear of being sued for infringement.[47] If this activity becomes widespread, publishers could either lower prices generally or simply eliminate distribution in foreign countries.

While *Kirtsaeng* involved textbooks, it is far from certain that other copyright industries are poised to share the same fate. To the extent that a price differential exists between the U.S. and foreign markets, of course, *Kirtsaeng* will likely have some impact. For example, in the DVD marketplace, prices have commonly been different between geographic regions because, unlike books, DVDs are generally made playable only on machines encoded with the ability to play discs specifically encoded for that region. The open question is whether "work-arounds," modified players, and advancing streaming and downloading technologies will ultimately permit *Kirtsaeng* to have a role.

One lesson from the software industry is the general practice of licensing copies, as opposed to selling them. The first sale doctrine only applies to sales, and, thus, a license would arguably not be subject to the exhaustion mandated by *Kirtsaeng*.[48] Similarly, copyright owners

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[47] *See, e.g.*, *Pearson Educ., Inc. v. Kumar*, No. 10-2610-cv, 2013 U.S. App. LEXIS 12632, at *1-2 (2d Cir. Jun. 20, 2013) (in light of *Kirtsaeng*, vacating the district court's judgment in favor of various publishers and directing entry of judgment in favor of the defendants on the claim that the resale in the U.S. of textbooks manufactured by the plaintiffs in India violated the Act).

[48] *But see AFL Telecommcns. LLC v. SurplusEQ.com Inc.*, No. CV11-1086 PHX DGC, 2013 U.S. Dist. LEXIS 71084, at *28 (D. Ariz. May 20, 2013) (holding that the first sale defense protected the defendant's later re-sale of certain fiber optic equipment containing copyright

could consider digital licensing of their works in addition to sales of physical copies as a means of supplementing their revenue stream. Moreover, they could justify engaging in price discrimination due to the greater portability and flexibility of digital copies.[49]

Finally, copyright owners should broadly consider the applicability of other intellectual property protections, such as trademarks, trade dress, and design patents—none of which are addressed by *Kirtsaeng*—to augment their rights under the copyright law.

Conclusion

As always, the U.S. Supreme Court term offers a fascinating, albeit slim, view into the laws governing intellectual property. *Already* and *Kirtsaeng* offer important lessons for intellectual property practitioners, owners, and users, while casting long shadows into the future for intellectual property protection, acquisition, licensing, research, and development.

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protected software that had been first manufactured and sold outside the U.S. to an exclusive distributor under a copyright license agreement).

[49] *Cf., e.g., Capitol Records, LLC v. ReDigi Inc.*, No. 12 Civ. 95 (RJS), 2013 U.S. Dist. LEXIS 48043, at *30-36 (S.D.N.Y. Mar. 30, 2013) (rejecting the first sale defense and holding that resale of "used" digital music files infringed on the rights to reproduce and distribute under the Act).