

CLIENT ALERT

Deep Sixed: Federal Circuit Boots Trademark Licensee for Meritless Claims Against U.S. Army

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On March 4, 2021, the Federal Circuit spoke pointedly on its view of contract interpretation and contract obligations in the context of trademark licensing agreements between private and government actors. In *Authentic Apparel Group, LLC v. United States*, No. 2020-1412 (Fed. Cir. Mar. 4, 2021), the court upheld the Court of Federal Claims' decision, on summary judgment, that the Army did not violate its obligations under a trademark licensing agreement with Authentic Apparel Group, LLC ("Authentic"). Authentic, the licensee, claimed that the Army violated the terms of the licensing agreement by refusing to approve certain products and marketing materials bearing Army trademarks. These included a proposed shoe line and an advertisement featuring Dwayne "The Rock" Johnson. The Federal Circuit disagreed.

The Federal Circuit emphasized the plain language of the trademark licensing agreement, which granted the Army "sole and absolute discretion" to approve or deny Authentic's proposed uses of the Army's marks. Additionally, an exculpatory clause provided that Authentic would have no cause of action based on the Army's exercise of this discretion in failing or refusing to grant approval. "Contracting parties," the court noted, "including parties who contract with the government, are generally held to the terms for which they bargained." This precept does not change merely because the subject matter of the contract is a trademark.

The court rejected Authentic's argument that the Army had effectively limited Authentic's use of the Army's marks only for decorative, rather than true "trademark," purposes. Authentic argued that, even if the discretionary clause authorized the Army to reject decorative uses, Authentic retained a right to use the marks in their source-identifying capacity—to identify the Army as the source or sponsor of the products. According to Authentic, in denying this right, the Army had effectively withheld access to the trademark goodwill on which the licensing agreement entitled it to trade.

The Federal Circuit was quick to take note of the peculiar, academic nature of Authentic's "trademark purposes" argument and to dispose of it as rooted in an outdated theory of trademark law—source theory. Trademarks, the court explained, are no longer limited in function to physical source or origin identification. Under the current quality theory of modern trademark law, trademarks may also serve as product quality indicators for consumers. Quality theory thus permits trademark licensing in a manner that source theory did not, provided the licensor maintains quality control over products.

With this background in place, the court turned to the critical flaw in Authentic's argument. Source theory would not create a right, as Authentic argued, for the business to use Army trademarks without Army approval in their source-identifying capacity. Rather, under source theory, Authentic could not have used Army marks at all. The reason? The Army was not the source of the products; the goods were required, under the contract, to be produced by Authentic. Use of the Army marks to denote only "source" would surely have resulted in consumer confusion in conflict with the goals of trademark law. Under quality theory, the phrase "trademark purposes" as used by Authentic is essentially meaningless. Moreover, the Army clearly satisfied its requirement for quality control. Indeed, much of Authentic's argument was that the Army was too strict in controlling use of its marks.

Although the court concluded the Army had not violated the trademark licensing agreement, it did note some opportunity for abuse of the agreement's broad terms. Specifically, the agreement required Authentic to pay minimum royalties despite lacking any counter requirement that the Army authorize at least some uses of its marks. Even under the broad contract terms here, the Army was still bound by the duty of good faith and fair dealing, including an obligation not to exercise its discretion in an arbitrary manner. Failure to act in accordance with these norms, the court suggested, might have been construed as a breach of the Army's contractual obligations. However, no such breach existed where the Army had approved 459 out of Authentic's 500 requests.

This opinion provides several key takeaways: (1) that the Federal Circuit is likely to employ standard principles of contract interpretation, including plain language analysis, even in the context of trademark licensing agreements; (2) that adequate quality control is a primary factor in determining whether a licensor has engaged in naked licensing, which may compromise the legitimacy of a trademark; and (3) that while discretionary and exculpatory clauses favoring the Government are likely to be upheld, Government action that is arbitrary or in bad faith may constitute a breach.

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