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ALERT

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Supreme Court Deciding Trademark Case with Broad Implications for the Principle of Corporate Separateness

By: Michael J. Schwab

In August 2023, a federal appeals court upheld a district court case ruling that declined to apply the principle of corporate separateness – that corporations have no liability for their affiliates' actions or obligations. Now, the U.S. Supreme Court has taken up the case – Dewberry Group, Inc. vs. Dewberry Engineers Inc. – and its ultimate decision could go a long way in determining how much flexibility courts may have in departing from that principle.

The justices heard oral argument for the case December 11, 2024, and will likely issue their decision later this term, but first, here's the backstory. It's somewhat dense, so bear with me, but a review of the details is necessary to understand the potential legal implications.

Dewberry Group, Inc. (DGI) and Dewberry Engineers Inc. (DEI) got embroiled in a trademark dispute involving about 30 of DGI's affiliated operating companies to which DGI furnished accounting, human resources, and certain legal services. These affiliates were legally well-defined entities that derived revenues from leasing commercial properties they owned to various tenants. DGI's revenue stream was entirely separate, consisting of contractual fees the affiliates paid in return for the services DGI extended to them.

DGI (then known as Dewberry Capital Corp.) ran afoul of DEI when the latter claimed that DGI's use of the trademark "Dewberry" infringed DEI's rights to the mark which was federally registered by DEI. DGI's subsequent settlement of the case included its agreement to stop using the trademark "Dewberry" and, adopt the mark "DCC" for services it provided in Virginia. But…after rebranding itself as Dewberry Group, Inc., the company created marketing materials that displayed the trademark "Dewberry Group" which DGI's affiliates also employed to promote its commercial properties to tenants. DEI responded by suing DGI for trademark infringement.

The Lower Court's Rationale

In August 2021, the U.S. District Court for the Eastern District of Virginia handed down a summary judgment in favor of DEI and followed that up, after a three-day bench trial, by ordering DGI to disgorge almost $43 million in profits.

Now, granted, the court admitted that DEI didn't present any evidence showing that DGI reaped any profits from the infringement (In fact, DGI sustained losses during the affected period). However, the Court said the award was proper and reasonable because of the "economic reality of how DGI's business actually operated."

Taking the point further, the court observed that DGI founder John Dewberry owned DGI and its affiliates; that DGI wouldn't exist but for the revenues generated by those affiliates; and that the affiliates – all of them managed and serviced by DGI – had earned about $43 million in profits from revenues created by commercial leases supported by the infringing mark. Therefore, it was appropriate to regard DGI and its affiliates as a single corporate entity when determining how much money (both revenues and profits) DGI generated through its use of the infringing mark.

Even though DEI hadn't named any DGI affiliates as defendants nor alleged any contributory infringement by them, the Court, in effect, said that was irrelevant because the Lanham Act gave it discretion to determine a fitting award based on "equitable considerations."

Why the Appeals Court Concurred

In affirming the district court's decision, the U.S. Court of Appeals for the Fourth Circuit held that the lower court had neither abused its discretion in determining that disgorgement was merited nor in the amount it awarded. The crucial basis for the circuit court's verdict was its assertion that, while the district court hadn't "pierced the corporate veil" between DGI and its affiliates, it nevertheless had found that DGI and its affiliates should be considered a single corporate entity for calculating how much revenue DGI had amassed from its use of the infringing mark.

Why is that significant? Because, traditionally, companies have relied upon a well-established understanding – one generally endorsed by the courts – that the doctrine of corporate separateness allows them to create and operate holding companies and/or affiliated (albeit carefully compartmentalized) corporate entities in order to shield certain assets from creditors' claims unless that corporate veil is pierced.

The Issue Before the High Court

So, now, the case is in front of the Supreme Court, which heard oral arguments on December 11, 2024.

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The justices ultimately will determine if a corporate defendant must pay trademark infringement damages on profits resulting from infringement activity that were attained by the defendant's nonparty corporate affiliates – but not by the defendant itself.

If the High Court were to upend – or else clarify and circumscribe the impact of – the rulings of the lower courts, it seemingly would be reaffirming the traditional, foundational principle of corporate separateness. But if it were to embrace the lower court rulings, the Court apparently would endorse the broad judicial discretion afforded in the Lanham Act to provide legal relief that would thwart a palpable injustice.

Yet the repercussions might not end there. Besides the Lanham Act, there are other statutes that empower courts with broad "equitable" discretion to remediate inequities, including the Copyright Act, the Patent Act, and the Employment Retirement Income Security Act. Therefore, any business that operates through holding companies or affiliated entities could be significantly impacted by the Court's decision in this matter.

If you have any questions regarding the matter raised in this Alert, please feel free to contact Michael J. Schwab at mschwab@moritthock.com or (212) 239-5527.

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