Blog Post

Lucky Opening Brief on Cert.: Second Circuit's Novel "Defense Preclusion" Rule Turns a Blind Eye on Bedrock Preclusion Principles

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In June 2019, the United States Supreme Court granted certiorari in *Lucky Brand Dungarees Inc., et al. v. Marcel Fashion Group Inc.*, No. 18-1086. As set forth in our prior blog posts, Lucky Brand Dungarees Inc. and related companies (collectively, "Lucky") seek a reversal of the Second Circuit Court of Appeal's ruling that Lucky was precluded by res judicata from asserting a release agreement defense, which was not previously litigated or resolved between Lucky and Marcel Fashion Group Inc. (Marcel). Specifically, the question presented is: "[w]hether, in cases where a plaintiff asserts new claims, federal preclusion principles bar a defendant from raising defenses that were not actually litigated and resolved in any prior case between the parties."

As our earliest blog on this case mentions, the trademark litigation between the parties has been going on for nearly two decades. The first suit, filed in 2001, resulted in a May 2003 settlement agreement (the Settlement Agreement). The second suit began in 2005, and ended in 2010 with judgment in favor of Marcel. In the third (and current), which began in 2011, Marcel alleges that after the 2005 case ended, Lucky used its own marks in ways that infringed Marcel's trademark rights.

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The current case has gone to the Second Circuit twice. In the first appeal of the current case, the Second Circuit held that Marcel's lawsuit could proceed because all of the alleged acts underlying Marcel's claims postdate the final judgment in the 2005 litigation. However, in the second appeal, which Marcel took after Lucky successfully asserted as a defense that Marcel's claims are barred by the Settlement Agreement, a different panel of the Second Circuit held that Lucky was "defense precluded" from raising the Settlement Agreement defense because Lucky *could have* litigated that defense to judgment in the parties' prior suit, but did not.

In its Opening Brief to the Supreme Court, Lucky argues that the Second Circuit's decision is (1) contrary to more than a century of Supreme Court precedent; (2) inconsistent with time-tested principles of *res judicata*; (3) inconsistent with the Federal Rules of Civil Procedure; and (4) would result in over-litigation of defenses.

First, Lucky contends that the Second Circuit's decision cannot be reconciled with the Supreme Court's case law on how to apply preclusion principles in the context of a defense to different claims than those previously litigated. Lucky analogizes this case to *Davis v. Brown*, 94 U.S. 423 (1877). *Davis* was the second suit between the same sets of parties. In the first suit, the plaintiff sued "second indorsers" of two promissory notes. In the second suit, the plaintiff sued the same "indorsers," but brought claims stemming from ten different promissory notes. The indorser-defendants argued that they could not be held liable for their "indorsements" because of an agreement with the bank that they claimed shielded them from liability. The plaintiff argued that *res judicata* barred the indorser-defendants from asserting their agreement with the bank as a defense, because they could have raised it in the first case, but did not.

The Supreme Court rejected the *Davis* plaintiff's position and explained that "[w]hen a judgment is offered in evidence in a subsequent action between the same parties upon a different demand," the judgment in first case "operates as an estoppel only upon [a] matter actually at issue and determined in the original action." Because the agreement defense had not been resolved in the first case, therefore, the indorser-defendants remained free to raise it in the second case. Lucky argues that *Davis* is controlling and that the Supreme Court need go no further than reaffirming *Davis* to reverse the Second Circuit. Lucky additionally emphasizes that neither the Supreme Court nor any other circuit court, with the exception of the underlying Second Circuit's opinion, has ever cast doubt on the vitality of the rule applied in *Davis* and itsprogeny.

Second, Lucky argues that the Second Circuit's decision is inconsistent with time-tested principles of *res judicata*. As Lucky frames the issue, the "preclusive effect of a judgment is defined by claim preclusion and issue preclusion, which are collectively referred to as '*res judicata*.'" *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008). Lucky argues that what the Second Circuit dubbed "defense preclusion," does not exist. Lucky explains that claim preclusion refers to the effect of a prior judgment in foreclosing successive litigation of the very same claim. However, it is fundamental, in Lucky's view, that claim preclusion applies only as far as the claim that was **actually resolved** in the prior case. See, e.g., *Clark v. Young & Co.*, 5 U.S. (1 Cranch) 181, 181 (1803)(Marshall, C.J.)

Unlike claim preclusion, the Lucky brief points out that issue preclusion refers to the effect of a prior judgment in foreclosing successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment, whether or not the issue arises on the same or a different claim. Lucky argues that claim preclusion has no application here, as all of the facts giving rise to the claims at issue arose after the

parties' prior litigation ended and are not the same as its claims in any of the prior lawsuits.

Third, Lucky asserts that the Second Circuit's decision is inconsistent with the Federal Rules of Civil Procedure (the Rules). According to Lucky, the Rules have long distinguished between claims, defenses, and compulsory and permissive counterclaims. However, Lucky contends, under the Second Circuit's novel "defense preclusion" rule, all defenses are given the preclusive effect of compulsory counterclaims, even when they are not counterclaims at all. In Lucky's view, the Second Circuit's decision collapses the Rules' clear and long-settled distinctions among claims, defenses, and counterclaims, where it gives all *defenses* preclusive equivalent of compulsory counterclaims and will be barred if not raised (and litigated to judgment) in response to the first claim to which they might apply.

Finally, Lucky argues that if the Second Circuit's decision is not reversed, it will result in unnecessary and inefficient over-litigation of defenses. Lucky suggests that the Second Circuit has established a "compulsory joinder of defenses" rule that will force counsel for defendants to raise and litigate to judgment every possible defense, for fear that their client be deemed "precluded" from raising the defense in a later case involving different claims.

Lucky further contends that this approach is particularly problematic in trademark cases, where at issue are distinctive marks and potentially distinguishing goods. Lucky explains that what distinguishes two marks today might not distinguish them tomorrow (or 5 or 10 years from now) and the likelihood of consumer confusion may change over time. Indeed, in Lucky's view, because the strength of trademark rights and defenses to trademark-infringement claims change over time, trademark defendants often have good reasons to raise a particular defense in one dispute, but not in another brought earlier or later. Accordingly, a defense that might be peripheral in an earlier case could become

crucial a decade down the line, even if many of the brands at issue are the same. Lucky concludes that no precedent or principle supports the Second Circuit's novel rule, and no policy interest commends it.

We will continue to follow this matter through the Supreme Court's decision.
