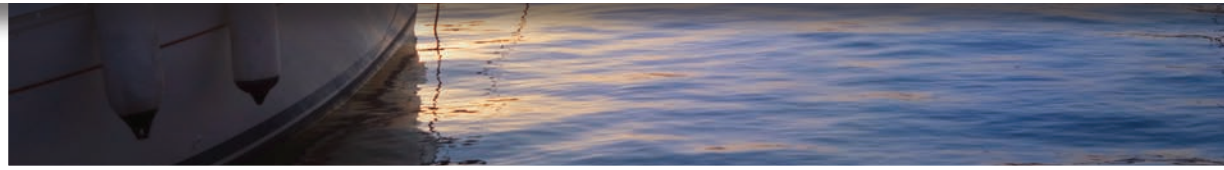




# IDEAS ON INTELLECTUAL PROPERTY LAW



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**The Halo effect**

*Appeals court upholds enhanced damages for willful infringement*

**Third parties allowed to assert work-for-hire defense**

**When is automation of a manual process patentable?**

**The naked truth**

*Valid assignments and agreements determine trademark rights*



Cantor Colburn LLP

## The *Halo* effect

### Appeals court upholds enhanced damages for willful infringement

It didn't take long for the Federal Circuit Court of Appeals to take the U.S. Supreme Court's June 2016 ruling in *Halo Electronics, Inc. v. Pulse Electronics, Inc.* out for a test drive. The *Halo* decision rejected the notion that patent infringers can escape liability for enhanced damages if they muster a reasonable (even though unsuccessful) defense at the infringement trial.

*WBIP, LLC v. Kohler Co.* represents the first appellate case to consider the propriety of enhanced damages for willful patent infringement since *Halo* was issued. Not surprisingly, a three-judge panel unanimously affirmed the enhanced damages award.

#### ALLEGED INFRINGER HITS ROUGH WATERS

Westerbeke Corporation and Kohler Co. are competitors that manufacture and sell marine generators to create electrical power for appliances on houseboats. Westerbeke assigned WBIP, LLC two patents dating back to 2003 for marine engine exhaust systems that reduce the amount of carbon monoxide in the exhaust from generators.

Westerbeke makes a low-carbon monoxide generator that incorporates the patented technology and introduced this generator at a 2004 boat show. Two Kohler employees attended the show and John Westerbeke, the inventor, explained to them how the technology works. About a year later, Kohler launched its own low-carbon monoxide generators.

In 2011, WBIP sued Kohler for infringement. A jury found that Kohler infringed the patents and failed to prove that the patents were invalid. It set a reasonable royalty rate and calculated damages at about \$9.6 million. The jury further found that the infringement was willful. The trial court



subsequently reduced damages to about \$3.8 million but enhanced them by 50% due to the willfulness of the infringement. Kohler appealed, seeking to have the judgment of willfulness reversed.

#### COURT THROWS DEFENSE OVERBOARD

Kohler argued that its defenses at trial regarding the invalidity of the patents were objectively reasonable and, therefore, enhanced damages were improper. However, as the appeals court observed, the Supreme Court's *Halo* decision put to rest the idea that objective recklessness (that is, that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent) must be found in every case involving enhanced damages for willful infringement.

The Supreme Court, in fact, cited the objective recklessness requirement as the principal problem with the former (*Seagate*) test for determining whether damages can be enhanced. Instead, the Court held that an infringer's subjective bad faith alone may support an enhanced damages award.

According to the Federal Circuit and the Supreme Court, culpability should be determined by assessing

the infringer's knowledge at the time of the challenged conduct. In other words, Kohler couldn't insulate itself from liability for enhanced damages by creating an invalidity defense for trial after engaging in the culpable conduct of "plundering" WBIP's patented technology prior to litigation. After *Halo*, the proof of an objectively reasonable "litigation-inspired" defense to infringement isn't a defense to willful infringement.

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Kohler asserted that the jury's willful infringement verdict should be overturned because the jury had insufficient evidence that the company knew about the patents at the time of infringement. Even after *Halo*, enhanced damages require knowledge of the infringed patent. Although Kohler conceded that it did in fact have prelawsuit knowledge of the patents, it contended that the jury wasn't presented with any evidence of this knowledge. Therefore, the jury had no basis to find, or even infer, that Kohler knew or should have known about a high risk of patent infringement.

However, the appeals court concluded that the jury had substantial evidence of Kohler's knowledge of the patents from discovery responses, communications with WBIP and patent numbers Westerbeke marked on its engines.

### COURSE IS SET

The appeals court's decision in *WBIP* makes clear the impact of the Supreme Court's *Halo* ruling. Infringers will no longer be able to conjure defenses at trial to evade enhanced damages. As the court noted, "timing *does* matter." And in the case of willful infringement, it's the infringer's knowledge of the patent at the time of the infringement — not its trial defenses — that counts. ■

## WHY SECONDARY CONSIDERATIONS MATTER

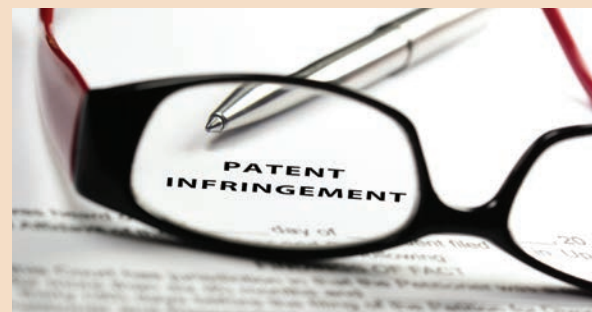
In addition to other conclusions (see main article), the Federal Circuit Court of Appeals in *WBIP, LLC v. Kohler Co.* clarified the potential weight of secondary considerations of nonobviousness. In other words, what objective evidence was relevant to the issue of whether a patent is invalid because the invention would have been obvious to someone with "ordinary skill" in the relevant field?

Secondary considerations are the last of the four factors (known as the *Graham* factors) for courts to use to determine obviousness. The defendant in *WBIP* argued that secondary considerations can never overcome a strong case of obviousness established under the other three factors:

- The scope and content of previous related inventions,
- The differences between the claimed invention and previous inventions, and
- The level of ordinary skill in the relevant field.

But the court explained that a determination of whether a patent is invalid as obvious requires consideration of all four *Graham* factors.

Moreover, the appeals court said, it had previously held that evidence of secondary considerations "may often be the most probative and cogent evidence." In this case, evidence of long-felt need, industry praise, and the defendant's copying and commercial success supported a finding that the invention was not obvious.



## Third parties allowed to assert work-for-hire defense

**W**ork-for-hire agreements generally give the hiring party, instead of the creator, ownership of any work's copyright. But as a recent Second Circuit case proves, third parties may be able to rely on the work-for-hire doctrine to crush a copyright infringement claim by a work's creator. In *Urbont v. Sony Music Entertainment*, the Second Circuit Court of Appeals addressed this issue for the first time.

### ORIGIN STORY

A songwriter sued Sony Music Entertainment and two other parties for infringement of the "Iron Man" theme song. Sony challenged his ownership of the copyright by arguing that the song was a work for hire created for Marvel Comics. The trial court agreed and found that the plaintiff didn't present sufficient evidence to rebut the presumption that Marvel was the copyright owner. It dismissed the case and the plaintiff appealed.

The plaintiff contended that the defendants, as third parties to any ownership agreement between himself and Marvel, lacked the necessary standing

to challenge his ownership rights using the work-for-hire doctrine. Under the doctrine, an employer that hires another party to create a copyrightable work is the author of the work for copyright purposes, unless there's an agreement to the contrary.

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Third parties to an alleged employer-employee relationship *do* have standing to raise a work-for-hire defense.

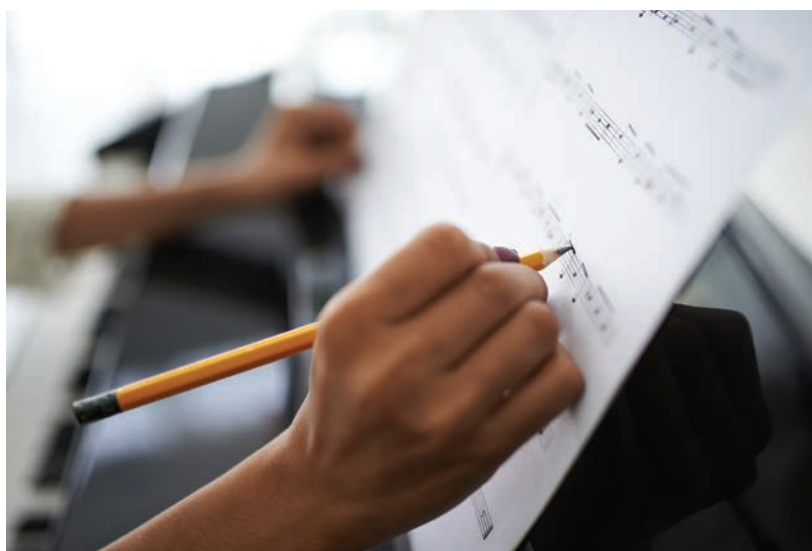
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The plaintiff argued that there was no evidence that Marvel, which wasn't a party to the lawsuit, had ever challenged his claim of ownership of the song. He stated that the defendants shouldn't be allowed to challenge the validity of his copyright when Marvel hadn't done so.

### DOCTRINE ISN'T IRONCLAD

The Second Circuit acknowledged that it has implicitly permitted use of the work-for-hire doctrine defensively by third-party infringers to refute a plaintiff's alleged ownership of a copyright. The court also noted that the Eleventh Circuit has explicitly held that a third-party infringer has the right to use the defense.

But this isn't true for all courts. The Ninth Circuit has rejected third-party standing for the work-for-hire doctrine, at least where both potential owners of the copyright were parties to the lawsuit and the issue of ownership was



undisputed between them. However, the Second Circuit pointed out, Marvel wasn't a party to the present suit and hadn't had the opportunity to clarify its position regarding ownership.

Ultimately, the Second Circuit decided that a plaintiff in a copyright infringement case must prove copyright ownership whether it's challenged by an ostensible employer or a third party. It found that third parties to an alleged employer-employee

relationship *do* have standing to raise a work-for-hire defense against a claim of infringement.

#### IN THE AFTERMATH

Parties engaged in copyright disputes involving works for hire should take note, regardless of the federal circuit court hearing their case. The existence or possible existence of a work-for-hire agreement in any jurisdiction means there's potential for arguments about ownership, including those by a third party. □

## When is automation of a manual process patentable?

Cases involving the patent eligibility of computer-related methods continue to plague the Federal Circuit Court of Appeals, which hears all patent case appeals. One notable new decision, *McRO, Inc. v. Bandai Namco Games America Inc.*, brings some important clarity and could have implications for other software.

#### ANIMATING THE CASE

McRO sued about two dozen video game developers, alleging they infringed its patent for a method of automatically animating lip synchronization sequences and facial expressions of 3-D animated characters. The patent automates part of an existing 3-D animation method.

Before the patented invention, animation of a character and lip synchronization was generally accomplished by an animator using a computer. McRO's patent aimed to automate a 3-D animator's tasks through the application of "exemplary rule sets." For example, one set of rules transitions a character from silence through saying "hello."

The trial court granted a motion for judgment on the pleadings and dismissed the lawsuit before trial, finding that the asserted claims were unpatentable. Specifically, the court decided that the novel portions of the invention were claimed too broadly and would preempt all other inventions related to lip synchronization using a rules-based approach. McRO appealed the decision.

#### RULES OF THE PATENT-ELIGIBILITY ROAD

Section 101 of the Patent Act defines patent eligibility for inventions. It provides that patent protection is available for any new and useful process, machine, manufacture or composition of matter, as well as any new and useful improvement of any of them. Abstract ideas generally aren't patent-eligible.

To determine whether an invention is patent-eligible, a court applies a two-step framework. First, it determines whether the patent covers an exception to Section 101, such as an abstract idea. If so, the court then asks if the patent's claims include an "inventive concept" that transforms the



nature of the claim into a patent-eligible application. Generic computer implementation of abstract ideas or processes won't make an otherwise ineligible invention eligible.

### COURTS NOT IN SYNC

The appeals court disagreed with the trial court's finding that McRO's patents covered the abstract idea of automated rules. It faulted the lower court for looking at the patent claims generally instead of accounting for specific requirements listed. The appeals court found that the patent was limited to rules with specific requirements that allowed for improvement over the existing technology.

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It also rejected the defendants' arguments that the invention simply used a computer to automate conventional activity. The court pointed out that there was no evidence that the process animators generally used was the same as the process required by the patent. According to the court, it was the

incorporation of the rules — not the use of a computer — that improved the existing process by allowing automation of tasks previously performed by animators.

Moreover, the court said, the patents wouldn't preempt all processes for achieving automated lip synchronization of 3-D characters. Incorporating the rules limited the patents to a specific process for automatically animated characters using particular information and techniques. Approaches that use rules of a different structure or different techniques wouldn't be preempted.

The appeals court concluded that the method wasn't an abstract idea but a patent-eligible technological improvement over the existing manual 3-D animation techniques. Therefore, the court didn't need to consider the second step of the framework. It reversed the trial court and sent the case back for further proceedings.

### THAT'S ALL, FOLKS

Unlike computer-related inventions found patent-ineligible in previous cases, the automation here *improved* on previously human-performed methods. The court's ruling suggests that patent eligibility may hinge on whether an invention simply automates an existing manual process or automates a new process not previously performed manually. □

## The naked truth

### Valid assignments and agreements determine trademark rights

It's not clear how the name of a famous Native American chief came to be associated with "adult entertainment," but it has. In Ninth Circuit Court of Appeals case *Russell Road Food and Beverage, LLC v. Spencer*, "Crazy Horse" was the subject of a trademark dispute. The case involved a complex series of interactions and arrangements between the parties.

#### FACTS LAID BARE

In 2006, Carl Reid registered the mark "Crazy Horse" for "entertainment services, namely, exotic dance performances." Russell Road Food and Beverage, LLC, later attempted to register the mark "Crazy Horse III Gentlemen's Club at the playground" for its strip club, and Frank Spencer, owner of a chain of strip clubs, tried to register the "Crazy Horse" mark. The U.S. Patent and Trademark Office refused the two applications based on a likelihood of confusion.

In 2007, another club owner, John Salvador, tried to register the name Crazy Horse Too. After the application was rejected, Salvador and Reid entered a trademark co-existence agreement that allowed Salvador to use and register "any mark that includes the

phrase Crazy Horse ...." In 2011, Salvador dissolved his company. In 2012, he assigned his rights under the co-existence agreement to Russell Road. Reid assigned his rights in the trademark to Spencer.

Russell Road subsequently sought a declaratory judgment that its use of the Crazy Horse name didn't infringe Spencer's trademark. The trial court granted the judgment.

#### COURT TAKES CENTER STAGE

Spencer appealed, but the appeals court affirmed the trial court's ruling. It explained that, when a trademark is assigned, the assignee steps into the shoes of the assignor. The assignee acquires not only the rights and priorities of the assignor but also any burdens and limitations on use that applied to the assignor. The court further noted that trademark co-existence agreements are enforceable and assignable.

Russell Road obtained only the rights that Crazy Horse Too had possessed, while both Spencer and Crazy Horse Too "retained the duties not to oppose each other's use of the Crazy Horse mark, to take

reasonable steps to reduce the likelihood of confusion, and so on." The agreement specifically provided that it was "binding upon and shall inure to the benefit of the parties hereto, their respective successors, assigns (sic) and licensees."

#### CURTAIN CALL

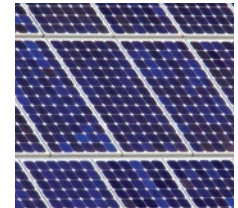
Even in the murky world of adult entertainment, trademark and contract law hold firm. That means valid assignments and agreements will determine parties' rights in the end. □





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