

## Not Just a *Flook*?: Consideration of Prior Art When Evaluating Subject Matter Eligibility

By Michael S. Borella, Ph.D.  
and Rory P. Shea

On May 10, 2013, the Federal Circuit handed down the much-anticipated *en banc* decision in *CLS Bank Int'l v. Alice Corp.*<sup>1</sup> This case is perhaps the most important 35 U.S.C. § 101 jurisprudence regarding the patent eligibility of computer-implemented inventions since the Supreme Court's *Bilski v. Kappos* and *Mayo v. Prometheus* decisions.<sup>2</sup> While the overall effect of this case remains to be seen and is likely to be a subject of heated debate, this decision has the potential to impact both patent litigation and prosecution.

As a brief introduction, the claims at issue included method, computer-readable medium (CRM), and system claims directed to facilitating a previously-arranged exchange between two parties requiring the use of "shadow" records maintained by a third-party "supervisory institution."<sup>3</sup> Although some of the claims do not expressly recite computer-based steps, the parties stipulated that all claims required electronic implementation using a computer and memory.<sup>4</sup> The district court initially found all asserted claims invalid under § 101, but a Federal Circuit panel reversed this decision.<sup>5</sup> The Federal Circuit subsequently granted CLS's petition for a rehearing and vacated the panel's reversal, paving the way for the *en banc* decision.<sup>6</sup>

In a *per curiam* opinion, the Federal Circuit affirmed the district court's holding that all of the computer-implemented claims at issue were not directed to patent-eligible subject matter under 35 U.S.C. § 101, with a majority of the court (7-3) affirming the district court's ruling that the

method and CRM claims are invalid under § 101 and an equally-divided court (5-5) affirming the district court's ruling that the system claims are invalid under § 101.<sup>7</sup> However, the Federal Circuit was unable to reach a consensus on a framework for evaluating patent eligibility of computer-implemented inventions going forward, and thus there was no majority opinion to support this affirmance. Rather, the decision included five different opinions, which are discussed below.

### Judge Lourie's Concurrence

The first opinion was Judge Lourie's concurrence, which was joined by Judges Dyk, Prost, Reyna, and Wallach.<sup>8</sup> Judge Lourie began by admitting the difficulty of analyzing patentability under § 101 and acknowledging the need for "a consistent, cohesive, and accessible approach to the § 101 analysis."<sup>9</sup> Judge Lourie then turned to the inevitable overview of Supreme Court decisions impacting § 101 as guideposts for this analysis.<sup>10</sup> In an example of judicial foreshadowing, he viewed *Benson*, *Flook*, *Diehr*, and *Bilski* cases through the lens of *Prometheus* and focused on the judicial exception to patentable subject matter when claims incorporate abstract ideas or laws of nature.<sup>11</sup> Leaning heavily on *Flook*, he applied *Prometheus*'s approach for analyzing such claims, with special concern on the practical likelihood of a claim preempting a fundamental concept.<sup>12</sup> This led Judge Lourie to the following four step analysis:

1. Determine "whether the claimed invention fits within one of the four statutory classes set out in § 101."<sup>13</sup>

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2. Determine whether “the claim pose[s] any risk of preempting an abstract idea.”<sup>14</sup>
3. If an abstract idea is implicated by the claim, “identify and define whatever fundamental concept appears wrapped up in the claim.”<sup>15</sup>
4. Finally, “[w]ith the pertinent abstract idea identified, the balance of the claim can be evaluated to determine whether it contains additional substantive limitations that narrow, confine, or otherwise tie down the claim so that, in practical terms, it does not cover the full abstract idea itself.”<sup>16</sup>

Judge Lourie equated this final step to requiring an “inventive concept,” i.e., “a genuine human contribution to the claimed subject matter.”<sup>17</sup> Judge Lourie stated that this step does not require “inventiveness” in the same sense that claims must be novel and nonobvious.<sup>18</sup> Rather, the analysis “considers whether steps combined with a natural law or abstract idea are so insignificant, conventional, or routine as to yield a claim that effectively covers the natural law or abstract idea itself,”<sup>19</sup> such as (1) limitations that were necessary to every practical use of the abstract idea,<sup>20</sup> (2) limitations that do not “amount to more than well-understood, routine, conventional activity previously engaged in by researchers in the field,”<sup>21</sup> (3) “token or trivial limitations,”<sup>22</sup> and (4) “bare field-of-use limitations ... where the claim as written still effectively preempts all uses of a fundamental concept within the stated field.”<sup>23</sup>

Applying this framework, Judge Lourie found that the method claims were invalid under § 101 because (1) they draw on the abstract idea of reducing settlement risk by effecting trades through a third-party intermediary and (2) fail to add

“significantly more” to this idea.<sup>24</sup> In doing so, Judge Lourie found that the computer participation in these claims fails to supply an “inventive concept” because it just performs accelerated calculations and thus does not meaningfully limit claim scope.<sup>25</sup>

For similar reasons, Judge Lourie also found that the CRM and system claims were invalid under § 101. With respect to the CRM claims, Judge Lourie opined that they were not truly drawn to a specific CRM but rather to the underlying method, so he treated the CRM claims as equivalent to the methods for § 101 purposes.<sup>26</sup> Further, with respect to the system claims, Judge Lourie noted that the only difference from the method claims was the addition of a few generic computer components that did not offer a meaningful limitation beyond generally implementing the method via a computer.<sup>27</sup>

## Chief Judge Rader’s Concurrence-In-Part and Dissent-In-Part

Chief Judge Rader presented the lengthiest opinion in opposition to Judge Lourie, and set forth an alternative framework for assessing patent eligibility of computer-implemented inventions that was joined by Judges Linn, Moore, and O’Malley.<sup>28</sup> Applying this framework, Judge Rader found the method and CRM claims invalid and the system claims valid under § 101.<sup>29</sup> Judge Moore joined these findings in their entirety, while Judges Linn and O’Malley only joined the findings with respect to the system claims.<sup>30</sup>

Judge Rader focused on the broad language of § 101 and the separation of the §§ 101, 102, and 103 patentability analyses, which he accused Judge Lourie of conflating with his “inventiveness” standard.<sup>31</sup> Judge Rader also took issue with Judge Lourie’s piecemeal approach to patent eligibility and

advocated for consideration of claims as a whole.<sup>32</sup> Judge Rader ultimately concluded that “[t]he relevant inquiry must be whether a claim includes *meaningful* limitations restricting it to an application, rather than merely an abstract idea.”<sup>33</sup> To assist with this inquiry, Judge Rader identified various factors that show a claim is **not** meaningfully limited:

- The claim “merely describes an abstract idea or simply adds ‘apply it.’”<sup>34</sup>
- The claim “covers all practical applications of an abstract idea.”<sup>35</sup>
- While the claim “does not wholly preempt an abstract idea, ... it contains only insignificant or token pre- or post-solution activity—such as identifying a relevant audience, a category of use, field of use, or technological environment.”<sup>36</sup>
- The claim’s “purported limitations provide no real direction, cover all possible ways to achieve the provided result, or are overly-generalized.”<sup>37</sup>

Correspondingly, Judge Rader identified two factors that show a claim **is** meaningfully limited:

- The claim “requires a particular machine implementing a process or a particular transformation of matter.”<sup>38</sup>
- “[I]n addition to the abstract idea, the claim recites added limitations” that are “central to the solution itself.”<sup>39</sup>

Notably, these factors overlap to a large degree with the factors of Judge Lourie’s approach. The main difference is that Judge Lourie focuses on the “human contribution” to the claim, while Judge Rader focuses on the claim as a whole. Another difference between the two approaches is their view on claim limitations directed to a general-purpose computer—Judge Lourie did not believe that these were meaningful limitations for purposes of § 101, while

Judge Rader found these limitations to be “an important indication of patent eligibility.”<sup>40</sup>

Applying his framework to the claims at issue, Judge Rader found the system claims to be patent eligible under § 101, because there was a lack of clear and convincing evidence that the claims as a whole were directed to an abstract idea.<sup>41</sup> Indeed, in Judge Rader’s view, labeling the system claims as an “abstract concept” would defy the meaning of that term in view of the structural components and relationships recited in those claims.<sup>42</sup>

On the other hand, Judge Rader found the method and CRM claims (which he considered together in view of Alice’s concession that they rise and fall together) invalid under § 101.<sup>43</sup> As a threshold issue, Judge Rader found that these claims embody “elements of abstractness which propel this court into further examination of [their] eligibility.”<sup>44</sup> Judge Rader then considered “whether the recited steps are inherent in an escrow and claimed at a high level of generality, such that in fact the claim is not to a practical application of the concept of an escrow, but in effect claims the abstract concept of an escrow”—which led him to conclude that the claims were **not** patent eligible.<sup>45</sup> Judge Rader also noted that the method claims’ implicit reference to computer implementation, without more, is insufficient to meet § 101.<sup>46</sup>

#### **Judge Moore’s Dissent-In-Part**

Judge Moore filed a separate opinion (which was joined by Judges Rader, Linn, and O’Malley) to further criticize Judge Lourie’s finding that the system claims were invalid under § 101, which echoed many of the same sentiments as Judge Rader’s opinion—including the desire for an approach that considers claims as a whole and avoids conflating the requirements of

§§ 101, 102, and 103.<sup>47</sup> Ultimately, Judge Moore decided that when looking at the hardware and software elements recited in the system claims, “it is impossible to conclude that [the system claims are] merely an abstract idea.”<sup>48</sup> Rather, Judge Moore found that these are “pure system claim[s]” that are “directed to a specific machine configured to perform certain functions,” and are thus patent eligible.<sup>49</sup>

snippets.

This case is perhaps the most important 35 U.S.C. § 101 jurisprudence regarding the patent eligibility of computer-implemented inventions since the Supreme Court’s *Bilski v. Kappos* and *Mayo v. Prometheus* decisions.

#### **Judge Newman’s Concurrence-In-Part and Dissent-In-Part**

Judge Newman took issue with the conflation of patent eligibility with the legal criteria of patentability, as well as the apparent failure to recognize the right to study and experiment with the knowledge disclosed in patents.<sup>50</sup> To address these issues, Judge Newman proposed a return to the statute. Under this proposed

approach, “when the subject matter is within the statutory classes in *section 101*, eligibility is established,” and then issues of patentability (e.g., claim breadth) would be addressed under the other sections of the statute.<sup>51</sup> Thus, Judge Newman found all of the claims at issue to be patent eligible.<sup>52</sup>

#### **Judge Linn’s and Judge O’Malley’s Dissent**

In stark contrast to their colleagues, Judges Linn and O’Malley would have reversed the District Court and found all claims patent eligible for procedural reasons. This is because the parties had stipulated that the claims included “whatever limitations Alice asserted a skilled artisan would assume they possessed”—which required electronic implementation using a computer and memory.<sup>53</sup> Consequently, Judges Linn and O’Malley faulted Judges Rader and Moore for improperly construing the method claims more broadly than the system claims, and also reproached Judge Lourie for importing the breadth of the method claims into the system and CRM claims.<sup>54</sup> Given the parties’ stipulation, Judges Linn and O’Malley would have the claims at issue rise or fall together.<sup>55</sup> With respect to the merits, Judges Linn and O’Malley found the system claims patent eligible for the reasons set forth in Judge Rader’s opinion, and they would also apply that same rationale to find the method and CRM claims patent eligible.<sup>56</sup>

#### **Endnotes**

- 1 No. 2011-1301, 2013 U.S. App. LEXIS 9493 (Fed. Cir. May 10, 2013) [hereinafter *CLS Bank*].
- 2 See *Bilski v. Kappos*, 130 S. Ct. 3218 (2010) [hereinafter *Bilski*]; *Mayo Collaborative Servs. v. Prometheus Labs., Inc.*, 132 S. Ct. 1289 (2012) [hereinafter *Prometheus*].

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- 3 *CLS Bank*, 2013 U.S. App. LEXIS 9493, at \*42-43.
- 4 *Id.* at \*43.
- 5 *Id.* at \*7.
- 6 *Id.* at \*7-8.
- 7 *Id.* at \*8, \*63.
- 8 *Id.* at \*7.
- 9 *Id.* at \*18.
- 10 *Id.* at \*19-27; see *Gottschalk v. Benson*, 409 U.S. 63 (1972) [hereinafter *Benson*]; *Parker v. Flook*, 437 U.S. 584, (1978) [hereinafter *Flook*]; and *Diamond v. Diehr*, 450 U.S. 175 (1980) [hereinafter *Diehr*].
- 11 *Id.* at \*27-29; see *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127 (1948) [cited as *Funk*].
- 12 *Id.* at \*32-36.
- 13 *Id.* at \*32.
- 14 *Id.*
- 15 *Id.*
- 16 *Id.* at \*33.
- 17 *Id.* at \*35.
- 18 *Id.* at \*34.
- 19 *Id.* at \*38-39.
- 20 *Id.* at \*37.
- 21 *Id.*
- 22 *Id.*
- 23 *Id.* at \*38.
- 24 *Id.* at \*43-45.
- 25 *Id.* at \*46.
- 26 *Id.* at \*51.
- 27 *Id.* at \*60.
- 28 *Id.* at \*63.
- 29 *Id.* at \*63-64.
- 30 *Id.*
- 31 *Id.* at \*94.
- 32 *Id.* at \*81.
- 33 *Id.* at \*84-85.
- 34 *Id.* at \*86.
- 35 *Id.*
- 36 *Id.* at \*88.
- 37 *Id.* at \*89.
- 38 *Id.* at \*90.
- 39 *Id.* at \*90-91.
- 40 *Id.* at \*92.
- 41 *Id.* at \*113.
- 42 *Id.* at \*109.
- 43 *Id.* at \*121.
- 44 *Id.* at \*118.
- 45 *Id.*
- 46 *Id.* at \*120-21.
- 47 *Id.* at \*122-23, 129-30.
- 48 *Id.* at \*138-139.
- 49 *Id.* at \*139.
- 50 *Id.* at \*143-44.
- 51 *Id.* at \*157.
- 52 *Id.* at \*160.
- 53 *Id.* at \*162-63.
- 54 *Id.* at \*166-67.
- 55 *Id.* at \*165-66.
- 56 *Id.* at \*174-75.

**Michael S. Borella, Ph.D.**, an MBHB associate, conducts legal research and provides technological advice in support of validity, infringement and patentability analyses, and litigation matters in the areas of computing, electrical engineering, and telecommunications.

[borella@mbhb.com](mailto:borella@mbhb.com)

**Rory P. Shea**, an MBHB partner, practices in all areas of intellectual property law, with a particular emphasis on patent litigation and patent preparation and prosecution in the areas of electrical engineering, computer software and hardware, and telecommunications.

[shea@mbhb.com](mailto:shea@mbhb.com)

## 2013 Chambers USA Favorably Ranks MBHB Among Top Law Firms in Intellectual Property

McDonnell Boehnen Hulbert & Berghoff LLP has been favorably ranked among top law firms in the 2013 legal directory *Chambers USA: America's Leading Lawyers for Business* in the category of "Intellectual Property." The latest annual survey of the U.S. legal market is published by the respected organization Chambers and Partners.

In addition, MBHB partner Daniel A. Boehnen is ranked as a legal industry leader in the category of "Intellectual Property" within the 2013 edition of *Chamber USA*.

Chambers identifies the best practitioners in all the main areas of business law. Chambers' rankings are compiled from interviews with top business leaders and legal advisors. The research is in-depth and client focused and the guide is read by industry-leading companies and organizations throughout the U.S. and worldwide. The qualities on which rankings are assessed include technical legal ability, professional conduct, client service, commercial astuteness, diligence, commitment and other qualities most valued by the client. The rankings and editorial comments about attorneys are independent and objective. Inclusion in the guide is based solely on the findings of the Chambers research team. No one can "buy their way in." Furthermore, Chambers' methodology for research into the strengths and reputations of law firms and individuals has been approved by the British Market Research Bureau. To view details regarding MBHB's ranking as it appears in Chambers' legal directory, visit [www.chambersandpartners.com](http://www.chambersandpartners.com).



# The USPTO Adopts New Rules of Professional Conduct

By Andrew W. Williams, Ph.D.

On May 3, 2013, the United States Patent and Trademark Office (“USPTO” or “Office”) Rules of Professional Conduct (“USPTO Rules”) went into effect to govern the ethical obligations for representing others before the Office. These new rules are based on the ABA Model Rules for Professional Conduct, and replaced the USPTO Code of Professional Responsibility, which dated back to 1985. Because almost every other U.S. jurisdiction had already adopted some form of the ABA Model Rules, this resulted in a harmonization of ethical standards.

The adoption of the USPTO Rules was a significant event for every patent practitioner. The updated rules were welcome news for patent attorneys, as such individuals are also required to know and abide by the ethics rules of the state or jurisdiction in which they practice. Because the USPTO had been operating under the USPTO Code of Professional Conduct, which itself was based on the former ABA Model Code from 1980, patent attorneys were required to maintain adherence to two different sets of ethical obligations. However, the adoption of these new rules might not be treated as welcome news by non-lawyer patent practitioners (patent agents), because they are also subject to the USPTO ethical guidelines, but they might not yet be aware of the differences and subtleties of the ABA Model Rules. Such individuals will need to transition from the previous set of legal ethics, the USPTO Code, which was for many their only real exposure to legal ethics. It is therefore essential that patent agents become accustomed to the new USPTO Rules, especially where they differ from the previous USPTO Code. Links to the new rules, as well as other related useful information, can be found at <http://www.uspto.gov/ip/boards/oed/ethics.jsp>.

## Confidentiality of Information

It is certain that every patent practitioner needs to review and become familiar with the new USPTO Rules. However, particular attention should be paid to what is probably the most significant practical difference between the USPTO Rules and the ABA Model Rules: when can or cannot a patent practitioner disclose a client’s confidential information? This issue generated the greatest number of comments from individuals and organization after the proposed rules were promulgated on October 18, 2012. ABA Model Rule 1.6 states that a practitioner shall not reveal a client’s confidential information without informed consent, implied authorization, or permission under the rules. USPTO Rule § 11.106, which is based on ABA Model Rule 1.6, reads as follows:

### §11.106 Confidentiality of information.

- (a) A practitioner shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, the disclosure is permitted by paragraph (b) of this section, or the disclosure is required by paragraph (c) of this section.
- (b) A practitioner may reveal information relating to the representation of a client to the extent the practitioner reasonably believes necessary:
  - (1) To prevent reasonably certain death or substantial bodily harm;
  - (2) To prevent the client from engaging in inequitable conduct before the Office or from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of

another and in furtherance of which the client has used or is using the practitioner’s services;

- (3) To prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client’s commission of a crime, fraud, or inequitable conduct before the Office in furtherance of which the client has used the practitioner’s services;
  - (4) To secure legal advice about the practitioner’s compliance with the USPTO Rules of Professional Conduct;
  - (5) To establish a claim or defense on behalf of the practitioner in a controversy between the practitioner and the client, to establish a defense to a criminal charge or civil claim against the practitioner based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the practitioner’s representation of the client; or
  - (6) To comply with other law or a court order.
- (c) A practitioner shall disclose to the Office information necessary to comply with applicable duty of disclosure provisions.

Both the new USPTO Rules and the ABA Model Rules include circumstances in which a practitioner “may” reveal such confidence, such as disclosing information that may prevent death, bodily harm, or fraud. However, even in the cases where death, bodily harm, or fraud may result, the practitioner is still not required to reveal such information under the ABA Model

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Rules, but rather has permission to do so. The new USPTO Rules diverge in one important respect: section (c) includes a type of information that is mandatory to reveal: “A practitioner shall disclose to the Office information necessary to comply with applicable duty of disclosure provisions.” In other words, under this rule, a finding that relevant information was intentionally withheld by a practitioner involved in the prosecution of an application will not only subject a patent to becoming unenforceable, it will result in an ethical violation by the practitioner.

The main reason that patent practitioners should be concerned is that this requirement has the possibility of creating a trap between two ethical obligations—a proverbial rock and a hard place. This is because this new obligation is not limited to the confidential information from the particular client in question, but instead extends to any confidential information belonging to any other client that is also material to the first client’s application. To be fair, a similar ethical quandary probably already existed, because if a patent attorney was aware of such third-party confidential information, they already had a duty to disclose it in order to prevent the patent from becoming unenforceable. But, because that attorney would have been subject to the ethical obligations of the state in which they practice, they would have at the same time been prevented from disclosing that same information. Moreover, most clients would prefer that their confidential information not be made publically accessible in another client’s patent file. It is of little concern to them that the practitioner has an ethical obligation to his or her other client. As a result, an attorney in such a quandary would have needed to discharge that duty by withdrawing from the case. See, e.g.,

*Molins PLC v. Textron, Inc.*, 48 F.3d 1172 (Fed. Cir. 1995).

It is not surprising, therefore, that most of the comments received on this issue questioned whether, under the new rules, an attorney in such an ethical quandary would be able to withdraw from such a case, and thereby discharge the ethical obligation. In the published Final Rules, the USPTO addressed these comments, but did not change the proposed rule. The USPTO’s response provided some justification for the rule as drafted. For example, the USPTO appeared to suggest that such an ethical quandary is unlikely because the restrictions on current client conflicts of interest “would generally prevent a practitioner from accepting clients who may have potentially adverse interests.” Unfortunately, this is not the test for whether there is a conflict of interest under ABA Model Rule 1.7 or USPTO Rule 107. Instead, a concurrent conflict of interest exists where the representation of two clients would be directly adverse, or where there would be a significant risk that the representation of either client would materially limit the representation of the other. Indeed, this requirement to disclose confidential information can arise when a current client discloses information to a practitioner that just so happens to be material to the patentability of another client’s application. Conflict screening will generally not prevent this.

This does, however, bring up another interesting issue regarding the interplay between the duty to disclose and the rules on whether a conflict exists. Just like ABA Model Rule 1.10, the USPTO Rules provide that the existence of a conflict of interest is imputed to everyone at a firm. In other words, if another attorney at a firm is performing legal services for a client, then

every attorney at that firm is thought to be working for that client, even if the other attorneys at the firm have no knowledge of that client and are not exposed to that client’s confidential information. In addition, it is generally not possible to “screen” or “wall” those attorneys off to avoid such a conflict. Instead, in such circumstances where a conflict arises, the firm is forced to decline the work that would cause the conflict. This imputation rule, however, does not apply to the duty of disclosure. Whether a practitioner is aware of a reference that is material to the patentability of an application is personal to that patent attorney or agent. Knowledge of a material reference is not imputed, so different attorneys representing different clients in similar spaces could be aware of art that would be material to the other client’s application and not be required to disclose it. This is because that attorney needs to have actual knowledge of the reference.

Nevertheless, whether those attorneys had actual knowledge of such a reference is a factual matter, and the consequences of a Court finding such knowledge can be detrimental to a client. Therefore, firms can take precautions to avoid even the appearance of impropriety. For example, firms can obtain USPTO customer numbers for use with specific clients. That way, if one client’s reference becomes relevant to another client’s application, as long as the attorneys of the second client are not associated with the first client’s customer number, it might be easier to establish that they never had knowledge of the reference in the first place. The only problem with such an approach is that in real-world practice, clients often hire firms because of that firm’s particular experience prosecuting applications in a particular technological space. It is exactly because

of this experience that these conflicts may potentially arise, and it is unlikely that all attorneys at a firm will be partitioned appropriately to discrete USPTO customer numbers. Nevertheless, use of client-specific customer numbers may work in certain situations to avoid this problem.

Ultimately, the USPTO did respond to the concerns expressed by the commenters by noting that a practitioner in such an ethical quandary might be able to withdraw from representation. For example, the USPTO pointed specifically to Rule § 1.116, which provides that in certain situations, such as when “[t]he representation will result in violation of the USPTO Rules of Professional Conduct or other law,” a practitioner may seek to withdraw to avoid the conflict of interest. Moreover, in the “Discussion of Specific Rule” section of the Federal Register notice, see 78 Fed. Reg. 20180, 20183 (April 3, 2013), the USPTO specifically stated that “if a practitioner has a conflict of interest in a given matter, arising from a different client, timely withdrawal by the practitioner from the given matter would generally result in OED not seeking discipline for conflicts of interest under part 11.” Even though the use of the word “generally” is troubling in this explanation, this is probably the best practical solution. As a result, if a patent practitioner remains vigilant and takes all necessary precautions, it is unlikely that he or she will fall victim to this ethical quandary.

**Andrew W. Williams, Ph.D.**, an MBHB partner, has a practice that concentrates in patent procurement and enforcement. He has extensive experience with patent litigation, prosecution, and opinion work in the areas of biotechnology, pharmaceuticals, and chemistry.

[williams@mbhb.com](mailto:williams@mbhb.com)

## MBHB Favorably Ranked in 2013 Edition of *IAM Patent 1000*

McDonnell Boehnen Hulbert & Berghoff LLP has been favorably ranked among top law firms in the 2013 edition of edition of *IAM Patent 1000 – The World’s Leading Patent Practitioners*. Published by *Intellectual Asset Management (IAM)* magazine, *IAM Patent 1000* is a unique guide that identifies the top patent practitioners in key jurisdictions around the globe.

MBHB is recognized in the 2013 edition of edition of *IAM Patent 1000* as follows:

- Ranked Silver Tier in Illinois for Patent “Litigation”
- Recommended in Illinois for Patent “Prosecution”
- Recommended in Illinois for Patent “Licensing”

MBHB attorneys are recognized in the 2013 edition of *IAM Patent 1000* as follows:

- Daniel A. Boehnen – Ranked Silver Tier in Illinois for Patent “Litigation”
- Paul H. Berghoff – Ranked Bronze Tier in Illinois for Patent “Litigation”
- Leif R. Sigmond, Jr. – Ranked Bronze Tier in Illinois for Patent “Litigation”
- Marcus J. Thymian – Recommended in Illinois for Patent “Prosecution”
- Kevin E. Noonan – Recommended in Illinois for Patent “Prosecution”
- Bradley J. Hulbert – Recommended in Illinois for Patent “Licensing”

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McDonnell Boehnen Hulbert & Berghoff LLP is pleased to announce firm partners Paul H. Berghoff, Daniel A. Boehnen, Bradley J. Hulbert, Kevin E. Noonan, Ph.D. and Leif R. Sigmond, Jr. were selected by their peers for inclusion in the *Best Lawyers in America*® 2014 edition. *Best Lawyers* is a highly respected peer-review publication that is widely regarded by both clients and legal professionals as a significant honor.

The MBHB partners are listed in the following *Best Lawyers*–designated specialty areas:

### **Biotechnology Law**

Kevin E. Noonan, Ph.D.

### **Litigation – Intellectual Property**

Paul H. Berghoff  
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### **Litigation – Patent**

Paul H. Berghoff  
Daniel A. Boehnen  
Leif R. Sigmond, Jr.

### **Patent Law**

Paul H. Berghoff  
Daniel A. Boehnen  
Bradley J. Hulbert

### **Trademark Law**

Daniel A. Boehnen

# Trademark Functionality in the Beverage Industry

**By Jeremy E. Noe, Sydney R. Kokjohn and David W. Haars**

Diageo, the world's largest producer of spirits,<sup>1</sup> has recently found itself in several significant trademark disputes regarding a number of the company's spirit lines. In a case decided in May 2012 Maker's Mark brought suit against Diageo regarding use of the dripping red wax seal made famous by Maker's Mark.<sup>2</sup> In a case decided in March 2013 American Beverage Corporation brought suit against Diageo over use of flexible foil pouches to deliver frozen cocktail products.<sup>3</sup> And in an ongoing case, Diageo brought suit against Mexcor alleging infringement of some of the company's Crown Royal marks.<sup>4</sup> This article discusses the outcome of the Maker's Mark and American Beverage cases, and discusses the strengths and weaknesses of the arguments asserted in the yet to be decided Mexcor case.

Maker's Mark occupies a central place in the modern history of bourbon. Having manufactured its recipe of bourbon since 1953, the company gained national attention in 1980 when *The Wall Street Journal* published a front page article about its bourbon.<sup>5</sup> In 1985, the company registered a trademark for the dripping red wax seal, which it described as a "wax-like coating covering the cap of the bottle and trickling down the neck of the bottle in a freeform irregular pattern."<sup>6</sup>

In 1995, Jose Cuervo began producing a line of premium tequila called, "Reserva de la Familia."<sup>7</sup> The tequila bottle initially featured a red wax seal that was straight-edged and did not feature drips, but by 2001, Cuervo was selling this tequila in the United States in bottles that included a red dripping wax seal similar to that of Maker's Mark.<sup>8</sup>

In 2003, Maker's Mark filed suit against Casa Cuervo S.A. de C.V., Jose Cuervo

International, Inc., Tequila Cuervo La Rojeña S.A. de C.V., and Diageo North America, Inc. alleging state and federal trademark infringement as well as federal trademark dilution.<sup>9</sup> The district court found that Maker's Mark's seal was a valid trademark. They also held that Cuervo had infringed that mark.<sup>10</sup> Cuervo appealed the district court's determination that the mark was not aesthetically functional, as well as some of the district court's findings regarding its confusion analysis.<sup>11</sup>

Regarding Cuervo's functionality allegations, the Court of Appeals for the Sixth Circuit held that a trademark may be found to be functional under the traditional functionality doctrine or the aesthetic functionality doctrine.<sup>12</sup> Under the traditional functionality doctrine, a trademark is functional if "it is essential to the use or purpose of the article or if it affects the cost or quality of the article."<sup>13</sup> The Supreme Court has discussed the aesthetic functionality doctrine in dicta, holding that in cases where a feature of the trademark has no "bearing on the use or purpose of the product or its cost or quality," it is proper to inquire into a significant non-reputation-related disadvantage.<sup>14</sup>

The Maker's court interpreted this dictum to propose that under the aesthetic functionality doctrine, where an aesthetic feature serves a significant function, "courts should examine whether exclusive use of that feature by one supplier would interfere with legitimate competition."<sup>15</sup> The court outlined two similar tests for the determination of aesthetic functionality. Under the Comparable Alternatives Test, a court should ask "whether trade-dress protection of certain features would nevertheless leave a variety of comparable alternative features that competitors may use to compete in the market."<sup>16</sup> Under the Effective Competition Test, a court

should ask "whether trade-dress protection for a product's feature would hinder the ability of another manufacturer to compete effectively in the market for the product."<sup>17</sup>

The court found that regardless of which test it used, Cuervo's appeal on the aesthetic functionality of the Maker's Mark trademark would not succeed.<sup>18</sup> The court held that because "there is more than one way to seal a bottle with wax to make it look appealing," Cuervo failed the Comparable Alternatives Test.<sup>19</sup> Similarly, the court held that "red wax is not the only pleasing color of wax, nor does it put competitors at a significant non-reputation-related advantage to be prevented from using red dripping wax."<sup>20</sup> Thus, Cuervo failed the Effective Competition Test as well.<sup>21</sup>

In another case involving a Diageo trademark dispute, in May 2012, American Beverage Corporation (ABC) filed a Motion for Preliminary Injunction against Diageo regarding the use of a flexible foil pouch to deliver frozen cocktail products.<sup>22</sup> In 2005, ABC began development of a "ten-ounce, single-serve ready-to-drink frozen cocktail product to be served in a flexible foil pouch."<sup>23</sup> The result was a pouch to be sold under its Daily's brand that has a wedge shape when viewed from the side and an hourglass shape when viewed from the front.<sup>24</sup> In early 2011, as a result of the success of the frozen pouch, Diageo sought to enter this market.<sup>25</sup> Diageo developed a frozen pouch product for its Parrot Bay™ and Smirnoff™ spirit lines that approximated the size and shape of the ABC pouches.<sup>26</sup>

In its complaint, ABC alleged that these Diageo pouches "infringe the design patent and trade dress utilized in the frozen cocktail products produced by ABC."<sup>27</sup> ABC is the licensee of Design Patent No. D571,672, which is directed to the



ornamental design for a flexible pouch. Regarding ABC's trade dress infringement claims, the court stated that in order to establish a likelihood of success on the merits, ABC must show that its trade dress design is nonfunctional and distinctive, and that there is a likelihood of confusion as to the source of the products.<sup>28</sup>

Regarding the functionality requirement, the court stated that "functional features are by definition those likely to be shared by different producers of the same product and therefore unlikely to identify a particular producer."<sup>29</sup> The court further stated that the Supreme Court's analysis regarding functionality is congruent with that of the Court of Appeals for the Third Circuit, noting that "a feature of goods is considered non-functional if the element of the product serves no other purpose than identification."<sup>30</sup>

The court held that "the existence of a design patent is presumptive proof of non-functionality."<sup>31</sup> The court found that ABC had produced substantial evidence that the shape of the pouch "is not essential to the purpose of the frozen cocktail" and that "the shape actually increases the cost of making the pouch."<sup>32</sup> Thus, the court held that, in light of ABC's design patent and the evidence produced, "a reasonable jury would find that the trade dress is non-functional."<sup>33</sup> The court, however, ultimately denied ABC's motion for a preliminary injunction because it failed to "show that money damages would be insufficient to remedy any resulting harm."<sup>34</sup>

In an ongoing case, Diageo is the plaintiff in a trademark dispute, regarding its Crown Royal™ line of Canadian Whisky.<sup>35</sup> On March 26, 2013, Diageo North America filed suit against Mexcor, Inc. and EJM Investments, LLC for trademark and trade dress infringement, unfair competition and

false designation of origin.<sup>36</sup>

Crown Royal is one of the most popular and recognizable brands of Canadian Whisky in the world. The whisky is packaged in a cloth purple bag with drawstrings and gold stitching.<sup>37</sup> Crown Royal began selling their whisky in the United States in the 1960's and today, its US annual sales are in the hundreds of millions of dollars.<sup>38</sup> Founded in 1989, "Mexcor is a Texas-based business that import[s], market[s], sell[s] and distribute[s] a variety of brands of alcoholic beverages."<sup>39</sup> Since at least as early as 2008, Mexcor has distributed a line of Canadian whisky using names and marks that include the word "crown," including Texas Crown Club™, Florida Crown Club™, and South Carolina Crown Club™.<sup>40</sup> This line of whisky is packaged in cloth bags having a distinctive state flag theme or a distinctive theme that suggests a state or regional locale.<sup>41</sup>

In its complaint, Diageo asserted that Mexcor's branding and packaging of their Crown Club™ line of whisky "exacerbate the likelihood of consumer confusion."<sup>42</sup> Specifically, it asserted that Mexcor's use of the "Crown-formative" trademarks, and soft, cloth bags with drawstrings at the top have caused, and will continue to cause, a likelihood of confusion and deception among members of the public, with respect to Diageo's Crown Royal word mark, purple bag mark, and the Crown Royal trade dress.<sup>43</sup>

In response, Mexcor asserted two counterclaims against Diageo.<sup>44</sup> Mexcor first seeks a declaratory judgment of non-infringement.<sup>45</sup> Mexcor additionally seeks cancellation of Diageo's purple bag mark on the basis of abandonment.<sup>46</sup>

The registration for Diageo's purple bag mark states that "the colors purple and

gold are claimed as a feature of the mark. Purple appears in the overall coloring of the bag design and gold appears in both the stitching and drawstring of the bag. The mark consists of a three dimensional design of a purple cloth pouch bag with gold stitching and drawstring."<sup>47</sup> During prosecution, the examining attorney stated that the "bag is a 'common' basic shape or design," and that it "is far from unique in the field in which it is used."<sup>48</sup> The examining attorney additionally stated that "gift pouches with double drawstring closings are almost generic for liquor gift bags."<sup>49</sup>

Regarding its abandonment claim, Mexcor asserted that "the use of a cloth bag to package alcoholic products is a functionally desirable method of packaging such products that is in common usage in the marketplace."<sup>50</sup> Mexcor asserted that this "common usage by different entities of cloth bags for many different alcoholic products ... causes such bags, without more, to lack the necessary distinctiveness to identify and distinguish a single source."<sup>51</sup> Because of this, Mexcor claimed that Diageo has abandoned, or at least partially abandoned, this mark to the extent that it might apply to other bags than those identical to that described in its trademark registration.<sup>52</sup>

On first glance, it appears that Mexcor should have also asserted a functionality defense regarding Diageo's purple bag trademark. However, upon closer consideration of the prosecution history of the mark, this might not be a strong argument. During prosecution, the Examining Attorney made an initial rejection of the mark based on functionality, stating that "the bag will simultaneously serve as ornament, protector, and carrier for the whisky."<sup>53</sup> In response, Diageo stated that "the underlying rationale for the functionality doctrine is to prevent trademark applicants  
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continued from p. 9

from acquiring potentially perpetual patent-style protection of utilitarian features through trademark laws.”<sup>54</sup> Diageo further argued that “the purple bag does not embody utilitarian features that, if used exclusively by Diageo, would place competitors at a disadvantage in terms of cost or ease of manufacture.”<sup>55</sup> The Examining Attorney found this argument to be persuasive and withdrew the functionality rejection.<sup>56</sup>

Based on this rationale, and in view of rulings in other cases as discussed above, the court is not likely to find that the purple bag is functional. Mexcor may yet have a route to prevail, however, if it focuses on the lack of similarity between the products and the widespread permeation of cloth bags in the spirit industry. Those in any industry where packaging is an important source identifier should follow the guidance regarding functionality set forth in the cases discussed above in order to avoid the loss of trademark rights.

## Endnotes

- 1 James Thompson, *Johnnie Walker popularity helps Diageo to toast profits*, The Independent (Aug. 27, 2010), <http://www.independent.co.uk/news/business/news/johnnie-walker-popularity-helps-diageo-to-toast-profits-2063217.html>.
- 2 *Maker's Mark Distillery, Inc. v. Diageo N. Am., Inc.*, 679 F.3d 410, 417 (6th Cir. 2012).
- 3 *Am. Bev. Corp. v. Diageo N. Am., Inc.*, CIV.A.12-601, 2013 WL 1314598 (W.D. Pa. 2013).
- 4 Complaint, *Diageo N. Am., Inc., v. Mexcor, Inc.*, No. 4:13-cv-00856 (S.D. Tex. Mar. 2013) [hereinafter “Diageo Complaint”].
- 5 *Makers Mark*, 679 F.3d at 416-417.
- 6 *Id.* at 417.
- 7 *Id.*
- 8 *Id.*
- 9 *Id.*

- 10 *Id.*
- 11 *Id.*
- 12 *Id.* at 418.
- 13 *Qualitex Co. v. Jacobson Prods Co.*, 514 U.S. 159, 165 (1995) (quoting *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 850 (1982)).
- 14 *TrafFix Devices, Inc. v. Mktg. Displays, Inc.*, 532 U.S. 23, 33 (2001).
- 15 *Makers Mark*, 679 F.3d at 418 (quoting *Antioch Co. v. W. Trimming Corp.*, 347 F.3d 150, 155 (6th Cir. 2003)).
- 16 *Id.* (quoting *Abercrombie & Fitch Stores, Inc. v. Am. Eagle Outfitters, Inc.*, 280 F.3d 619, 642 (6th Cir. 2002)).
- 17 *Id.* (quoting *Abercrombie*, 280 F.3d at 642).
- 18 *Id.*
- 19 *Id.*
- 20 *Id.* at 418-419.
- 21 *Id.*
- 22 *Am. Bev. Corp.*, WL 1314598 at \*1.
- 23 *Id.* at \*2.
- 24 *Id.*
- 25 *Id.* at \*3.
- 26 *Id.* at \*4.
- 27 *Id.* at \*1.
- 28 *Id.* at \*28.
- 29 *Id.* at \*29.
- 30 *Id.* (quoting *Ideal Toy Corp. v. Plawner Toy Mfg. Corp.*, 685 F.2d 78, 81 (3d Cir. 1982)).
- 31 *Id.* at \*30.
- 32 *Id.*
- 33 *Id.*
- 34 *Id.* at \*50.
- 35 See Diageo Complaint.
- 36 *Id.* at ¶ 1.
- 37 *Id.* at ¶ 2.
- 38 *Id.* at ¶¶ 14, 18.
- 39 Answer at ¶ 83, *Diageo North America, Inc., v. Mexcor, Inc.*, No. 4:13-cv-00856 (S.D. Tex. Mar. 2013) [hereinafter Mexcor Answer].

- 40 *Id.* at ¶ 3.
- 41 *Id.*
- 42 Diageo Complaint, at ¶ 4.
- 43 *Id.* at ¶ 54.
- 44 See Mexcor Answer, at ¶¶ 114, 116.
- 45 *Id.* at ¶ 114.
- 46 *Id.* at ¶ 116.
- 47 U.S. Trademark No. 3,137,914 (registered Sept. 5, 2006).
- 48 See *id.* at Office Action dated Oct. 3, 2005.
- 49 *Id.*
- 50 Mexcor Answer, at ¶ 93.
- 51 *Id.*
- 52 *Id.* at ¶ 116.
- 53 U.S. Trademark No. 3,137,914, Office Action dated Mar. 10, 2005.
- 54 *Id.* at Response dated Sept. 9, 2005.
- 55 *Id.*
- 56 *Id.* at Office Action dated Oct. 3, 2005.

**Jeremy E. Noe**, an MBHB partner, has a practice that spans all aspects of patent litigation, patent and trademark preparation and prosecution, opinion preparation, and client counseling. He has extensive litigation experience, particularly in protecting client interests at preliminary injunction proceedings and at trial.

[noe@mbhb.com](mailto:noe@mbhb.com)

**Sydney R. Kokjohn**, an MBHB partner, has a concentration in patent procurement and enforcement. Her litigation experience focuses upon pharmaceuticals and medical devices. In addition, she prepares and prosecutes patent applications and provides technological advice in support of validity, infringement and patentability analyses in the areas of chemical engineering.

[kokjohn@mbhb.com](mailto:kokjohn@mbhb.com)

**David W. Haars**, was a 2013 summer associate with MBHB.



**McDonnell Boehnen  
Hulbert & Berghoff LLP**

300 South Wacker Drive  
Chicago, Illinois 60606-6709

312 913 0001 phone  
312 913 0002 fax  
www.mbhb.com  
snippets@mbhb.com

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