

INTELLECTUAL PROPERTY LITIGATION

BY LEWIS R. CLAYTON

'Bilski': Obtaining Business Method Patents Gets Harder

Nearly 30 years ago, the U.S. Supreme Court declared that a patent may be granted on "anything under the sun that is made by man." *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980). On the other hand, the Court has historically refused to allow patents on mere ideas and mental processes.

In the quaint language of *LeRoy v. Tatham*, 55 U.S. 156, 175 (1952), a "principle, in the abstract, is a fundamental truth; an original cause; a motive; these cannot be patented; as no one can claim in either of them an exclusive right." "[L]aws of nature, natural phenomena, [or] abstract ideas" are not patentable. *Diamond v. Diehr*, 450 U.S. 175, 185 (1981).

Business Method Patents

These concepts are in high tension in the controversial area of business method patents—claims that cover a process for achieving a business objective, rather than for producing a tangible product or bringing about a physical result. How can a line be drawn between a business method—for example, an accounting system used by mutual funds, or a process for conducting an auction or arbitrating commercial disputes—and an abstract idea? Courts have wrestled with that question since the U.S. Court of Appeals for the Federal Circuit's landmark decision in *State Street Bank & Trust Co. v. Signature Fin. Group Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), which is considered a broad endorsement of business method patents.

These issues were the focus of the Federal Circuit's eagerly awaited en banc decision in *In re Bilski*, 2008 WL 4757110 (Fed. Cir. Oct. 30, 2008). By a 9-3 vote, the en banc court



affirmed the rejection of a business method patent application by the Board of Patent Appeals and Interferences. Its opinion shifts the balance in this debate, making it significantly more difficult to obtain and defend business method patents.

The application considered in *Bilski* covered a method for hedging risk in commodities trading. It contemplates a market participant who acts as an intermediary, agreeing to sell a commodity at a fixed price to a user, while buying the same commodity at a second fixed price from a producer. The claim extends beyond trading in physical commodities to transactions in commodity options. The board rejected the application on the ground that it claimed an abstract idea.

Section 101 of the Patent Act allows for patents only on a process, machine, manufacture or composition of matter. *Bilski's* claim, like nearly all business method applications, can fit only in the process category. The issue, as the Federal Circuit saw it, was "what test or set of criteria governs the determination...of whether a claim to a process is patentable under §101 or, conversely, is drawn to unpatentable subject matter because it claims only a fundamental principle." The court of appeals found that this question, in turn, depends on "whether the effect of allowing the claim would be to allow the patentee to pre-empt substantially all uses of that fundamental principle. If so, the claim is not drawn to patent-eligible subject matter."

The Test

Parsing Supreme Court precedent, the court identified the proper test: "A claimed process is surely patent-eligible under §101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing." (Emphasis in original.) Conversely, where "all of the process steps may be performed entirely in the human mind," the claim is "obviously not tied to any machine and does not transform any article into a different state or thing." The court's rationale is that a patent covering a process tied to a particular machine does not preempt use of the principle underlying the process with another machine, and that a claimed process that transforms a specified article does not preclude use of the principle "to transform any other article, to transform the same article but in a manner not covered by the claim, or to do anything other than transform the specified article."

In reaching this conclusion, the Federal Circuit explicitly rejected several alternative tests. *State Street* has been read to hold that a process that produces a "useful, concrete and tangible result" is patentable, but the court found this test "insufficient." At the other end of the spectrum, it also rejected the idea, urged by several amici, that patents should be limited to "technological arts"—presumably matters of science or mathematics. Nor, the court held, can a claim be saved by limiting its application to a particular area (such as commodities trading, the subject of *Bilski's* application) or field of use.

While certainly rooted in Supreme Court decisions, the two-part test the court has adopted is arguably an awkward and imprecise method to draw a line between patentable inventions and ideas that are public property, especially where an idea can profitably be used only in connection with a particular machine or article. However, absent Supreme Court intervention—and recently, the Supreme Court has usually reduced the rights and protections of patent holders—the two-part test will govern.

Bilski's application failed the test. The claim did not call for use of a machine. Nor did it

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transform any article: "Purported transformations or manipulations simply of public or private legal obligations or relationships, business risks, or other such abstractions cannot meet the test because they are not physical objects or substances, and they are not representative of physical objects or substances." The claimed process was "directed to the mental and mathematical process of identifying transactions that would hedge risk."

After *Bilski*, litigants in business method patent cases will focus more intently on whether the claims at issue are sufficiently tied to a machine, apparatus or article. For some time, the claims of many business method patents have been drafted to require use of a machine (for example, a standard computer). Where an article or machine is not closely enough tied to the process, however, merely including such a limitation may not be enough.

The *Bilski* court cautioned that "the use of a specific machine or transformation of an article must impose meaningful limits on the claim's scope to impart patent-eligibility" and that "the involvement of the machine or transformation in the claimed process must not merely be insignificant extra-solution activity." In addition, even if such a claim passes muster under §101, it may be invalidated as obvious under §103. Last year, the court in *In re Comiskey*, 499 F.3d 1365, 1380 (Fed. Cir. 2007), which considered a business method patent, emphasized that "[t]he routine addition of modern electronics to an otherwise unpatentable invention typically creates a prima facie case of obviousness."

One of the *Bilski* dissents warned that the majority's holding would call into question applications that claim "many of the kinds of inventions that apply today's electronic and photonic technologies, as well as other processes that handle data and information in novel ways." But it is far from clear that the opinion will have any such effect (in fact, the majority opinion includes dicta that appears designed to protect patents on methods of manipulating specific data for analytic or scientific purposes). It is safe to predict, however, that *Bilski* will, on balance, raise the bar for holders of business method patents.

Copyright

Harry Potter author J.K. Rowling and the film studio behind the movies of the same name won an injunction to stop publication of an unauthorized encyclopedia of the people, places and things in the Harry Potter universe. *Warner Bros. Entm't Inc. v. RDR Books*, 2008 WL 4126736 (S.D.N.Y. Sept. 8, 2008). After a bench trial, the court ruled that the encyclopedia copied enough of the original works to constitute an infringement of the copyright owners' exclusive right of reproduction. The encyclopedia did not, however, violate plaintiffs' right to control the production of derivative works because it did not simply abridge or summarize the original works. Instead, it took material from voluminous and diverse sources and condensed and reorganized

it into an A-to-Z reference guide that allows the reader to understand specific elements from the larger Harry Potter world.

On the issue of fair use, the court found that the encyclopedia's use of the Harry Potter novels was at least somewhat transformative, even though it added no significant analysis or commentary, because it made information from the series available for reference purposes rather than for the entertainment purposes of the original works. But the transformative value of the encyclopedia was outweighed by its verbatim copying and close paraphrasing of the original works in excess of what was reasonably necessary to create a reference guide.

Distinguishing the Supreme Court's decision in *Quality King Distribs. Inc. v. Lanza Research Int'l Inc.*, 523 U.S. 135 (1998), the court in *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008), held that the Copyright Act's first sale doctrine is not a defense against a claim for infringement based on unauthorized sale in the United States of copyrighted products that were manufactured and sold by the copyright owner overseas.

The issue, the Federal Circuit said, was "what test... governs the determination... of whether a claim to a process is patentable under §101 or, conversely, is drawn to unpatentable subject matter because it claims only a fundamental principle."

The first sale doctrine, codified in §109 of the Copyright Act, provides that once a copyright owner consents to the sale of a work, he cannot later object to the sale of that work further down the stream of commerce. *Omega S.A. made and sold watches in Switzerland, which Costco imported and sold in the United States without authorization.*

Finding Costco liable for infringement, the Ninth Circuit held that, under the statutory text, the first sale doctrine may apply only to goods manufactured or authorized for sale in the United States. The court distinguished *Quality King*, where a first sale defense was recognized, because the copyrighted goods at issue there, although sold abroad, were manufactured in the United States.

In *In re Barboza*, 2008 WL 4307451 (9th Cir. Sept. 23, 2008), the Ninth Circuit held that a finding of willful copyright infringement is not the equivalent of a finding of "willful" injury within the meaning of §523(a)(6) of the Bankruptcy Code. After they were ordered to pay damages for willful copyright infringement, defendants filed for bankruptcy and sought to discharge the debt. The bankruptcy court ruled that the debt was nondischargeable because it resulted from a "willful and malicious" injury within the meaning of 11 U.S.C. §523(a)(6).

The Ninth Circuit reversed, noting that willful copyright infringement may include acts that are merely "reckless," and therefore do not rise to the level of deliberate or intentional conduct required under §523(a)(6). Because it was unclear whether the jury's finding of willfulness in the underlying copyright action was based on a finding of recklessness, the case was remanded to the bankruptcy court for determination of whether the infringement was willful under §523(a)(6).

Trademark

In *Facenda v. N.F.L. Films Inc.*, 2008 WL 4138462 (3d Cir. Sept. 9, 2008), the estate of John Facenda, a sports announcer famous for narrating football films sued the National Football League and related defendants for the unauthorized use of Mr. Facenda's voice in a program promoting the release of a new football video game. Defendants did not dispute that Mr. Facenda's voice is distinctive and potentially protectable as an unregistered trademark. Instead, they argued that the use of Mr. Facenda's voice was unlikely to cause confusion among consumers as to Mr. Facenda's endorsement of the program. In vacating summary judgment for plaintiff on its claim for false endorsement, the Third Circuit held that likelihood of confusion is a factual inquiry that should be handled at trial and not resolved on summary judgment. The court also ruled that plaintiff's state law right of publicity claim was not preempted by federal copyright law because the program, which was akin to advertising, did not count as an expressive work subject to the exclusive domain of copyright law.

Patents

"Reverse payments" are settlements of patent litigation in which the maker of a brand-name drug pays a generic drug company to abandon a challenge to a patent on the brand-name drug and agree to delay introduction of a generic drug in the market. Such settlements have generated a good deal of controversy and opposition from government agencies such as the Federal Trade Commission. In *In re Cipprofloxacin Hydrochloride Antitrust Litigation*, 2008 WL 4570669 (Fed. Cir. Oct. 15, 2008), the Federal Circuit rejected an antitrust challenge to a reverse payment settlement, holding that such a settlement is valid as long as it does not "restrict competition beyond the exclusionary zone of the patent"—for example, by imposing restrictions on the marketing of other products. Rejecting the views of several amici including the FTC, the court held that, absent evidence of fraud during patent prosecution or that the settled litigation was nothing more than a sham, a court should not consider the strength of the patent in determining whether the settlement violated the antitrust laws.

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