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Expert Analysis

'Bilski' and Business Method Patents, Further Issues Raised by Internet

By **Lewis R. Clayton**

On June 28, 2010, the last day of its term, the U.S. Supreme Court issued its eagerly awaited opinion on one of the most controversial issues in patent law, business method patents, *Bilski v. Kappos*, 2010 WL 2555192. Those who hoped that the Court would simply do away with business method patents—or at least announce a stringent test that would limit their grant or enforcement—were disappointed. While four justices would indeed outlaw business method patents, the majority of the Court refused to go that far, affirming the Patent Office's rejection of a business method application but leaving for the future the development of a comprehensive set of criteria to govern claimed business method inventions.

The patent application considered in *Bilski* claimed a method for hedging against the risk of price changes in commodities markets. According to the Court, the claims described "a series of steps instructing how to hedge risk," and expressed those concepts in a "simple mathematical formula." Certain claims also "suggest familiar statistical approaches to determine the inputs" to use in the formula.

Section 101 of the Patent Act provides for four categories of inventions eligible for patent protection: processes, machines, manufactures and compositions of matter. Business method claims such as Bernard L. Bilski's seek protection as "processes." The Federal Circuit affirmed the rejection of the Bilski application by the Board of Patent Appeals and Interferences. In doing so, the Court of Appeals applied a "machine-or-transformation test," finding patentability if a process is "tied to a particular machine or apparatus," or "transforms a particular article into a different state or thing."

A 5-4 majority of the Supreme Court (in an opinion authored by Justice Anthony M. Kennedy and joined by Chief Justice John G. Roberts, and Justices Clarence Thomas, Samuel A. Alito and Antonin Scalia) reached the same result, but through a different path. Analyzing the language of §101 of the act, the majority found no basis for the "broad contention," urged by some commentators and several amici, that "the term 'process' categorically excludes business methods."

And defining such an exclusion would be difficult—it is not "clear how far a prohibition on business method patents would reach, and whether it would exclude technologies for conducting a business more efficiently." Rather, the expansive language of §101 admits of only three exceptions to patentability recognized by Supreme Court precedent "going back 150 years": "laws of nature, physical phenomena, and abstract ideas."

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Mr. Bilski's application, the majority concluded, covers unpatentable abstract ideas, expressing the "basic concept of hedging, or protection against risk." Allowing such claims "would preempt use of [risk hedging] in all fields, and would effectively grant a monopoly over an abstract idea." Significantly, however, the majority did not describe a test to be used in separating acceptable business method patents from applications that attempt to appropriate abstract ideas.

The majority explicitly held that the Federal Circuit had erred in holding that the machine-or-transformation test is the only determinant of the patentability of a process. That test is no more than "a useful and important clue, an investigative tool, for determining whether some claimed inventions are processes under §101." The majority invited the Federal Circuit to establish additional criteria to judge patentability: "In disapproving an exclusive machine-or-transformation test, we by no means foreclose the Federal Circuit's development of other limiting criteria that further the purposes of the Patent Act and are not inconsistent with its text."

Justice John Paul Stevens' concurrence (joined by Justice Ruth Bader Ginsburg, Stephen G. Breyer and Sonia Sotomayor) seized on this ambiguity. The majority "never provides a satisfying account of what constitutes an unpatentable abstract idea." This "mode of analysis (or lack thereof) may have led to the correct outcome in this case, but it also means that the Court's musings on this issue stand for very little."

The four concurring justices would have rejected the application on the ground that, in their view, going back to the drafting of the Constitution, American patent law has always been understood to exclude methods of doing business. In addition, the concurrence asserted that recognizing such patents would restrain competition, without any offsetting gain from increased innovation. While it took the majority to task for failing to set out the grounds of its analysis, the concurrence made no attempt to define how and why a "business method" differs from the kinds of inventions used in business that may be patented.

It is likely that the Federal Circuit will now take up the difficult task of developing new criteria to assess the patentability of a process. In considering business method applications, the Court of Appeals may well be influenced by the fact that four members of the current court (albeit including one who has just retired) believe that no business method may be patented. The *Bilski* opinion may also spur legislation. Senator Patrick Leahy, the chairman of the Judiciary Committee who has been active in proposed patent reform legislation, said that *Bilski* "needlessly left the door open for business method patents to issue in the future, and I am concerned that it will lead to more unnecessary litigation." The courts, Mr. Leahy said, "are constrained by the text of our outdated statutes, and it is time for Congress to act."

Patents

Section 292 of the Patent Act is a criminal provision prohibiting the false marking of an unpatentable article with a patent number for the purpose of deceiving the public. Violations are punishable by a civil fine of $500 for each offense—assessed for each falsely marked article—and suits

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may be brought by any member of the public. In view of the broad standing and harsh remedy imposed by the statute, the courts impose a particularly high bar for proving deceptive intent. That high bar is illustrated by *Pequignot v. Solo Cup Co.*, 2010 WL 2346649 (Fed. Cir. June 10, 2010), where a patent attorney sued Solo, a cup maker, alleging that Solo had mismarked over 21 billion cup lids, seeking an award of more than $10.8 trillion.

Mismarking occurred because Solo knowingly continued to use production molds that added patent numbers to cup lids even after those patents expired. It did so based on outside counsel's advice that it was permissible to use the molds—which can last as long as 15 to 20 years—until they wore out. Affirming summary judgment for Solo, the Court of Appeals sustained the trial court's finding that Solo acted "in good faith reliance on the advice of counsel and out of a desire to reduce costs and business disruption," not with intent to deceive the public. Nor did Solo act with deceptive intent when, on advice of counsel, it produced packaging stating that its products "may be covered by one or more" patents. This language did not state that the products were "definitely" covered by any patent, and consumers were directed to Solo's Web site for detailed information.

Copyright

In *Golan v. Holder*, 2010 WL 2473217 (10th Cir. June 21, 2010), the U.S. Court of Appeals for the Tenth Circuit held that a federal statute granting copyright protection to some foreign works that had previously fallen into the public domain does not violate the First Amendment. The Tenth Circuit reversed the district court's grant of summary judgment to plaintiffs, a group of educators, performers, publishers, film archivists, and motion picture distributors.

The Uruguay Round Agreements Act (URAA), 17 U.S.C. §§104A, 109, was passed to implement the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs), which the United States entered in 1994. TRIPs required signatories to extend copyright protection to foreign works whose copyright term had not expired. Accordingly, the URAA restores copyright protection to foreign works that entered the public domain due to noncompliance with formalities, lack of subject matter protection, or lack of national eligibility.

The Tenth Circuit agreed with the district court that the URAA is a content-neutral regulation of speech subject to intermediate scrutiny under the First Amendment. Unlike the lower court, however, the Court of Appeals found that the government had demonstrated a substantial interest in securing legal protection for American copyright holders' interests abroad, and that the URAA—reflecting the reciprocal commitment of signatories to TRIPs—was narrowly tailored to serve that interest.

LimeWire is the latest peer-to-peer (P2P) file-sharing service—following in the footsteps of Napster, Kazaa, Morpheus, and Grokster—to be held liable for inducement of copyright infringement by users. In *Arista Records LLC v. Lime Group LLC*, 2010 WL 2291485 (S.D.N.Y. May 11, 2010, amended May 25, 2010), 13 major record companies sued the distributor of LimeWire, presenting evidence that nearly all of the downloads requested through the service were unauthorized.

The trial court granted summary judgment to plaintiffs on their claim of inducement of infringement, relying on *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005). The court found "overwhelming evidence" that defendant "engaged in purposeful conduct that fostered infringement" by creating and distributing LimeWire. Defendant was aware of extensive infringement, targeted its marketing to infringing users, included features that helped users find infringing files, used a business model dependent on infringing activity and failed to implement technologies to track and limit infringement. The court also rejected defendant's argument that conduct prior to the 2005 *Grokster* decision should not be considered as evidence of inducement, noting that "an inducement claim is a form of the long-established cause of action for contributory infringement."

Viacom Int'l Inc. v. YouTube Inc., 2010 WL 2532404 (S.D.N.Y. June 23, 2010), granted summary judgment dismissing copyright infringement claims against YouTube. Viacom alleged that over 150,000 unauthorized video clips of copyrighted material had been posted on YouTube and viewed 1.5 billion times. The trial court found that defendants were protected by the safe harbor for user-generated content established by the Digital Millennium Copyright Act (DMCA), 17 U.S.C. §512(c). An online service provider is eligible for the safe harbor if it complies with certain requirements, including a set of notice-and-takedown procedures for removing infringing content.

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The court recognized that "a jury could find that the defendants not only were generally aware of, but welcomed, copyright-infringing material being placed on their website." But it held this was not enough for liability. The court found that, in order for a service provider to lose safe harbor protection, it must have "knowledge of specific and identifiable infringements of particular individual items. Mere knowledge of prevalence of such activity in general is not enough." Because defendants qualified for the safe harbor, the court held them immune from liability on all claims of infringement. This victory may be short-lived, as Viacom has announced it intends to appeal.

Trademark

A recent U.S. Court of Appeals for the Eleventh Circuit decision demonstrates the importance of identifying the relevant population of consumers before undertaking likelihood of confusion analyses in trademark cases. In *Caliber Automotive Liquidators Inc. v. Premier Chrysler, Jeep, Dodge, LLC*, 605 F.3d 931 (11th Cir. 2010), a company that provides promotional services to car dealerships under the service marks "Slash-It! Sales Event" and "Slasher Sale" sued a car dealership owner for trademark infringement and false designation of origin under the Lanham Act for running infomercials called "Slasher Shows."

The district court considered evidence of actual confusion of two audiences—plaintiff's car dealership customers, who were confused by the infomercials, and car-buying retail customers, who were not—and concluded that, on balance, there was only a "slight" amount of confusion overall. The Eleventh Circuit reversed the district court's grant of summary judgment to defendant, holding that car dealerships were the consumers of plaintiff's services and their confusion should have been given significantly more weight. "The district court erred by overvaluing lack of confusion exhibited by the general public, an audience with no experience in the advertisement-buying market."

Gucci America Inc. v. Frontline Processing Corp., 2010 WL 2541367 (S.D.N.Y. June 23, 2010), indicates that credit card processing services may be liable for contributory trademark infringement if they knowingly supply essential services to Web sites whose sole purpose is to sell counterfeit goods. The luxury goods maker Gucci sued Woodforest and Frontline, two providers of credit card processing services to a Web site that sold counterfeit Gucci merchandise, and a third defendant, Durango, who matched credit service providers with the Web site. The district court dismissed Gucci's claims of direct and vicarious trademark infringement, but held that Gucci had stated a claim for contributory infringement.

The court found that a contributory infringement claim was viable where a defendant had (1) "intentionally induced" a Web site operator to sell counterfeit goods, or (2) supplied services with knowledge of infringement, while it had "sufficient control over the instrumentality used to infringe." Gucci pled sufficient facts to show that Durango had intentionally induced infringement—Durango allegedly specialized in providing financial services for "High Risk Merchant Accounts," including sellers of "Replica Products," and allegedly knew that the Web site was dealing in counterfeits. Gucci sufficiently alleged that Woodforest and Frontline knew of the infringement or were "willfully blind" to it. And Woodforest and Frontline had sufficient control over the Web site because their services were "essential" to the infringing activity—sales of counterfeit goods—and they could have refused to do business with Internet merchants who sold "replica" goods.

The U.S. Court of Appeals for the Second Circuit has not ruled definitively on the standard for contributory infringement in this context, and the *Gucci* decision arguably is in tension with *Perfect 10 v. Visa Int'l Serv., Ass'n*, 494 F.3d 788 (9th Cir. 2007), which found that financial institutions could not be contributorily liable for processing payments for infringing images displayed on a Web site.