CITE AS: 2 HASTINGS SCI. AND TECH. L.J. 131

IN RE BERNARD L. BILSKI AND RAND A. WARSAW

545 F.3d 943, 88 U.S.P.Q.2D (BNA) 1385 (Fed. Cir. 2008)

I. STATEMENT OF THE FACTS

Petitioner Bernard L. Bilski ("Bilski") filed for a patent on 10 April 1997 for a method of hedging risks in commodity trading. Essentially, the application claimed a method comprised of: (1) initiating a series of options transactions with commodity purchasers at a fixed rate based on historical price levels; (2) identifying sellers of the commodity; (3) initiating a series of options transactions with commodity sellers at a second fixed rate, such that the risk positions of the purchasers and sellers balances out. The PTO rejected all 11 claims because "the invention is not implemented on a specific apparatus and merely manipulates [an] abstract idea and solves a purely mathematical problem without any limitation to a practical application, therefore, the invention is not directed to the technological arts." *Ex parte Bernard L. Bilski and Rand A. Warsaw,* Appeal No. 2002-2257*,* Before the Board of Patent Appeals and Interferences (Mar. 8th 2006). Bilski appealed to the Board of Patent Appeals and Interferences ("BPAI"), which affirmed the finding of the examiner on different grounds. The BPAI concluded that Bilski's claims did not involve any patent-eligible transformation, and did not produce a "useful, concrete and tangible result." *Id.* Bilski appealed to the Federal Circuit, which then reheard the matter *en banc*.

II. HOLDING

The court upheld the rejection, 9-3. It found that Bilski's method was patent-ineligible because it did not "transform any article to a different state or thing." It rejected all other tests for patent-eligibility, relying solely on the machine-or-transformation test.

III. REASONING

Specifically, the court found (1) Bilski did not argue that the method was tied to a particular machine, so it did not reach the machine-implementation branch of the test, and (2) legal obligations and business risks "cannot meet the test because they are not physical objects or substances, and they are not representative of physical objects or substances." 545 F.3d 943, 963 (Fed. Cir. 2008).

The court examined Supreme Court and Federal Circuit precedent leading up to *Bilski* that bore on patent-eligibility. It stated that the trilogy of cases (*Benson, Flook, Diehr*) supported a legal test that requires that "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." *Id*. at 954.

The court then decided whether or not the preceding test is the only test for patent-eligibility, answering that question in the affirmative. It did point out two caveats to the machine-or-transformation test: "(1) mere field-of-use limitations are generally insufficient to render an otherwise ineligible process claim patent-eligible; (2) insignificant postsolution activity will not transform an unpatentable principle into a patentable process." *Id*. at 957

The court then said that the "useful, concrete, and tangible result" test espoused in *State Street Bank v. Signature Financial Group*, 149 F.3d 1368 (Fed. Cir. 1998) is inadequate, relying on Justice Breyer's dissent from the dismissal of certiorari in *Laboratory Corp. of Am. Holdings v. Metabolite Labs., Inc.,* 548 U.S. 124, 136-37 (2006). However, the court did *not* expressly hold that *State Street* should be overruled. It only dropped a footnote stating that "those portions of our opinions in *State Street* and *AT&T* relying solely on a 'useful, concrete and tangible result' analysis should no longer be relied on." 545 F.3d 943 at 959 n.17.

IV. OBSERVATIONS

At first glance, the Federal Circuit's categorical rejection of the "useful, concrete, and tangible result" test announced in *State Street* in favor of the machine-or-transformation test for patent-eligible subject matter could be seen as the death knell for business method and software patents. If the Court upholds *Bilski*, software patents issued in the past 20 years, as well as many business method patents, might be invalidated. However, this might not be the case. Gene Quinn, a patent attorney and the founder of IPWatchdog.com observes that, "[i]n fact, based on what is going on at the USPTO one could make a convincing argument that it is actually getting easier to obtain patents that relate to software and computer related processes. What my firm has been seeing is that claims can be made allowable by inserting "computer implemented" into claims, sometimes even in the preamble." (Gene Quinn, *US Supreme Court Grants Cert. in Bilski*, IPWatchdog.com, June 1, 2009, http://www.ipwatchdog.com/2009/06/01/us-supreme-court-grants-cert-in-bilski/id=3865/).

The worst outcome for the case would be one that decreases incentives for settlement. If the court reverses *Bilski*, and reinstates the *State Street* test, then the machine-or-transformation test will be just one test of several from which a district court may pick. This would give the district court's flexibility in determining the patentability of business methods and software patents, as patentees would always argue for *State Street*'s lax standard of "useful, concrete, and tangible result," while infringers would demand that the claimed method or process be tied to a machine (or otherwise transform an article into another form). The uncertainty created by such a situation would deter settlement and increase litigation.

Mr. Quinn's observation may be based on the USPTO taking a wait-and-see approach to the issue. From a public choice perspective, the USPTO might be attempting to avoid rejecting applications based on *Bilski* so that it doesn't find itself re-reviewing the same application once the Supreme Court issues its opinion. Going forward, the most sensible approach to acquiring patents is to include disclosures that would be appropriate under *State Street*, *Bilski*, and *Diamond v. Diehr* (recognizing as patentable software that is tied to a particular machine).

***

PRINCO CORPORATION AND PRINCO AMERICA CORPORATION V. INTERNATIONAL TRADE COMMISSION

563 F.3d 1301, 90 U.S.P.Q.2D (BNA) 1673 (Fed. Cir. 2009)

I. STATEMENT OF THE FACTS

In the late 1980s and the early 1990s, Phillips, Sony, and a few other large technology companies began collaborative research into rewriteable CD technology (CD-R, CD-RW). Both companies came to the realization that in order for the laser to accurately read and write to the disc, the laser's position relative to the disc must be known precisely. The two companies, in exchanges between engineers, settled on using a spiral with wobbles at regular intervals to serve as a track and a clock for the laser. Phillips proposed an analog implementation, encoding the position data by modulating the frequency of the wobble, while Sony utilized a digital modulation method. The two solutions solved the same problem, but are inherently incompatible—CD players using the Phillips approach would not be able to read CDs made using the Sony approach, and vice versa. The industry now uses the analog method.

Writeable and rewriteable CDs are manufactured using a set of patents held by several companies, among them being Sony, Phillips, Taiyo Yuden, and Ricoh. In the early 1990s, the companies agreed to pool the patents and have the pool administered by Phillips. Included in this pool were both the analog method and the digital (Lagadec) method. Licenses are issued from this pool to manufacturers of CD-Rs and CD-RWs, and no license for an individual patent may be issued.

Princo manufactures CD-Rs. They took a license from the pool, but then stopped paying the royalty, and Phillips sued in the ITC. At the ITC, Princo admitted infringement, but asserted the affirmative defense of patent misuse. Princo alleged that the inclusion of the alternative digital technology in the patent pool constituted tying and price-fixing, as it required payment of royalties on unused and unnecessary patents. They also argued that the inclusion of the Lagadec method patent also sequestered a viable work-around technology, preventing competitive development. Their basic allegation is that Phillips bribed Sony not to compete by offering them licenses to their unused Lagadec patent. The ITC rejected both of these arguments, and Princo appealed to the Federal Circuit.

II. HOLDING

The court affirmed the ITC's holding as to Princo's first tying claim, but vacated and remanded the ITC rejection of Princo's second claim of patent misuse.

III. REASONING

In affirming the ITC's holding as to Princo's first tying claim, the court found that a reasonably broad reading of the Lagadec patent (Sony's digital method) would support a finding of infringement where anyone practiced the Phillips analog method, currently used as the industry standard. Under the broad construction, since neither patent could be practiced without infringing the other, the court found the Lagadec patent to be essential to the patent pool. However, the Federal Circuit vacated and remanded Princo's claim of patent misuse. The court found persuasive Princo's argument that Phillips and Sony violated anti-trust law by agreeing not to compete, and remanded the issue to the ITC to determine whether there was in fact such an agreement and whether the Lagadec method could realistically compete with the Orange Book standard.

IV. OBSERVATIONS

The court here, with respect to Princo's second claim, is pointing out the difference between pooling essential patents together to reach a precompetitive effect, and not allowing licenses to be taken to any of those patents for other uses. Patent pooling and some forms of such tying are a double-edged sword—on one hand, the tying of patents to other patents or products can cause blocking of progress and other anti-competitive effects, while on the other hand the pooling of patents may lead an industry forward towards standardization and convergence. Princo's last best hope is to convince the court that by refusing to license the Lagadec patent for uses *other* than those consistent with the Orange Book standard, Sony and Phillips have engaged in violations of classic antitrust prohibitions against agreements not to compete. *See*, *e.g.*, *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49 (1990); *Otter Tail Power Co. v. United States*, 410 U.S. 366, 377 (1973).