



Intellectual Property

Year in Review 2010

Milbank

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has established a significant intellectual property practice ...

– *Benchmark Litigation 2011*

is renowned in the patent litigation field, thanks to its handling of major infringement cases for clients in a diverse range of sectors. The team also undertakes a significant amount of licensing work, both domestically and abroad. Clients benefit from the firm's international platform, which includes offices in the USA, Europe and Asia. SOURCES SAY: "They have stood up and actually argued cases in court; they've got great trial experience under their belts."

– *Chambers USA 2010*

is recommended for IP patent litigation

– *PLC Which Lawyer? 2010*

is a leading IP firm for contentious patent matters

– *Managing Intellectual Property's World IP Survey 2010*

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- Financial Technologies Forum LLC's Cloud Computing on Wall Street: A Breakfast Briefing, New York, NY
Litigation partner Rick Sharp moderated a panel titled "Regulation, Risk Management & Compliance," which discussed disaster recovery, licensing and regulatory issues. IP associates Blake Reese and Michael Kurzer co-authored the materials for the panel discussion.

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- GTCbio's The Future of Bio-based Chemicals – Inception to Marketplace, San Francisco, CA.
IP partner Larry Kass's presentation titled, "Knowing Your Investors when Securing Funding for Biofuels," focused on intellectual property in discussing the relative importance of assets and risks for biofuel entities, whether and how these dynamics are changing as the biofuel market matures, and investment trends globally and domestically.
- AIPLA's "Intellectual Grid": Intellectual Property Issues in Smart Grid Innovations (Webinar).
IP partner Larry Kass and other members of the panel discussed the basic parts of the smart grid; the technical & business backdrop of smart grid-related innovations; and IP issues & landscape in the space.

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- BNA LegalEdge's "Back to the Future (*Lubrizol*): An overview of IP & Bankruptcy issues, Chapter 15, and the *Qimonda* Proceeding" (Webinar)
IP partner Michael Murray moderated and associates Blake Reese (Intellectual Property) and Brad Friedman (Financial Restructuring) were panelists. They discussed the importance of understanding intellectual property issues in bankruptcy and financial restructuring, and how strategy may have been affected by the recent *Qimonda* decision.

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Speaking Engagements:

- IPO's Asia Practice Committee Meetings, Beijing, People's Republic of China.
IP practice group leader Chris Chalsen, who is Vice Chair of IPO's Asia Practice Committee, co-lead the delegation's meetings with various IP-related organizations in China. Delegates shared experiences and perspectives with patent practitioners and the judiciary of China on intellectual property practice.
- Intellectual Property Owners, Inc. ("IPO") Annual Meeting, Atlanta, GA.
IP partner Chris Chalsen participated in an international panel on "The Sum of All Fears: Compulsory Licensing as an Emerging IP Issue." The panel discussed recent developments, issues, cases and legislation associated with compulsory licensing from various geographical perspectives, including the U.S., Europe, Taiwan and China.
- 2010 AIPPLA Partnering in Patents Conference – An Open Dialogue between the USPTO and the Bar, Washington, DC.
IP partner Chris Gaspar presented on "Latest Guidelines to Obviousness from the Courts."
- IPO's Winning Trade Secrets Litigation: The Plaintiff's Toolkit (Webinar).
Chris Gaspar participated in a panel that discussed various tools to protect a company's valuable information and competitive position. They discussed various issues, including preliminary injunction strategies, protecting trade secrets from disclosure and use of protective orders, and effective case and trial themes.
- NYIPLA's CLE patent program, New York, NY.
IP associate Jim Klaiber participated in the Settlement & Damages panel. He presented on "Using Settlement – Negotiated Licenses in Litigation, and Using Licenses in Settlement Negotiation." IP associate Wayne Chang provided assistance in the preparation of the presentation.
- NYC Bar: Intellectual Property Due Diligence in Business Transactions, New York, NY.
IP associate Jim Klaiber presented on "Patent Due Diligence", and discussed the types of transactions in which due diligence investigations occur, the purpose of patent due diligence, scope of the investigation, the importance of representations and warranties, and tips for recording security interests in the US Patent and Trademark Office.

INTRODUCTION

Milbank Intellectual Property Year in Review

At Milbank, we serve our clients not only by recognizing and studying important developments in intellectual property law as they occur, but also by timely evaluating their potential impact on our clients' legal and business concerns. Throughout the past year, a number of developments have impacted intellectual property law in the areas of biopharma, software, business methods, cloud computing, clean energy and bankruptcy, in addition to numerous other areas. Milbank IP attorneys have evaluated these developments and applied them in practice, while educating the profession through articles and presentations. This annual IP review presents a selection of articles from 2010 addressing issues that continue to be cutting edge in 2011.

Milbank is a leading international law firm that has been providing legal solutions to clients throughout the world for more than 140 years. Our lawyers operate out of 11 global offices, including a newly-opened office in São Paulo, Brazil. Our intellectual property law group leverages multi-jurisdictional resources and capabilities to provide comprehensive and sophisticated IP services that the world's leading businesses require. In addition, we apply our intellectual property expertise for our world renowned clean energy project finance and bankruptcy practices. Our lawyers, most of whom are technically trained, have a wealth of expertise in a diverse array of technologies. As a result, the articles in this review at the same time reflect the authors' depth of understanding and their diversity of expertise.

The following is a summary of the five areas we focus on in this year's IP annual review.

Section I: Pharmaceuticals and Biotechnology

Several important developments for pharmaceuticals and biotechnology arose in 2010. Most significant perhaps was the new legislation for follow-on biologics (FOBs), the Biologics Price Competition and Innovation Act, which was passed under the Patent Protection and Affordable Care Act as part of the health care reform of 2010. In *Financier Worldwide's* "Global Reference Guide -- Biotech & Pharmaceuticals 2010," Errol Taylor and Larry Kass summarized the newly enacted legislation, compared it to the Hatch-Waxman Act, and discussed its potential impact on innovators. And in an article for *Corporate Counsel*, Arie Michelsohn drilled down to describe the complex "dance" that biologic innovators and generics must perform in the prelude to an FOB litigation under the new legislation.

Milbankers also analyzed recent developments that were seen as potentially paradigm shifting and put them into practical perspective based on recent experience. In an article for *BNA's Patent, Trademark & Copyright Journal*, Fred Zullo and Anna Brook provided an in-depth analysis that questioned the

impact of *KSR v. Teleflex* on chemical cases before the Federal Circuit, and found *KSR* has not turned out to be the “game changer” many thought it would be. For that same journal, Jack Griem and Larry Kass drew upon their knowledge about a number of recent developments in biopharma cases to suggest strategies that pharmaceutical patent holders might take in preparing for generic challenges. Larry and Nate Browand also followed up on an article they coauthored in 2009, where they had asked “Is There A Written Description Requirement After All?” In 2010, the Federal Circuit issued its landmark *en banc* opinion in *Ariad Pharms. Inc. v. Eli Lilly & Co.* Larry and Nate authored an article in the *New York Law Journal* explaining how the *en banc* opinion answered their question with a definitive “yes” and further analyzed the impact of the multifaceted opinion.

Section II: Software and Business Methods

As we entered 2010, the fate of software and business method patentability was in jeopardy. Many predicted the U.S. Supreme Court would simply render such subject matter unpatentable. But in its landmark opinion of *Bilski v. Kappos*, the Court took a more nuanced -- some say confused -- approach that left the door open to patentability. Mark Scarsi and Blake Reese analyzed the decision and its impact on business method patents pending before the Patent and Trademark Office in an article printed in the *Hedge Fund Law Report*. Blake Reese also surveyed decisions that issued after *Bilski* in an additional article and in speaking engagements. Milbankers also examined other intersections of IP law with software and computing that are particularly timely in view of the explosion of open source and cloud computing. In an article featured in *Inside Counsel*, Mark Scarsi explained how companies must be careful when using open source code in their proprietary systems. In *Traders Magazine* and in presentations

during the year, Rick Sharp, Blake Reese and Michael Kurzer provided tips and guidance for financial institutions on how to approach outsourcing agreements with cloud computing service providers, focusing on the need for service level commitments and regulatory compliance.

Section III: Clean Energy

In 2010, clean energy continued to draw attention from the profession, the public, and policymakers. Larry Kass authored an article in the *National Law Journal* studying how the *GE v. Mitsubishi* wind turbine litigation at the ITC transformed into a public policy dispute, drawing in numerous prominent politicians as advocates for one side or the other. Larry was extensively quoted about the *GE v. Mitsubishi* litigation in a number of articles in *The New York Times* and *Windpower Monthly*. He also covered other clean energy technologies as well, participating in several prominent speaking engagements, panel discussions and webinars that addressed solar energy, biofuels, and the smart grid.

Section IV: Bankruptcy

Milbank IP and bankruptcy practices complement each other and combine to provide substantial expertise in navigating intellectual property issues arising in bankruptcy proceedings and restructuring transactions. Milbankers shared some of that expertise in several publications and speaking engagements throughout 2010. In articles appearing in *BNA's Patent, Trademark & Copyright Journal* and *Bankruptcy Law Reporter*, associates Jim Klaiber and Brad Friedman wrote about whether certain ITC intellectual property investigations served as exceptions to the Bankruptcy Code's automatic stay provisions. In those same journals, Blake Reese and Brad Friedman examined the conflict between the territoriality of the international patent laws and provisions of the bankruptcy code that permit a

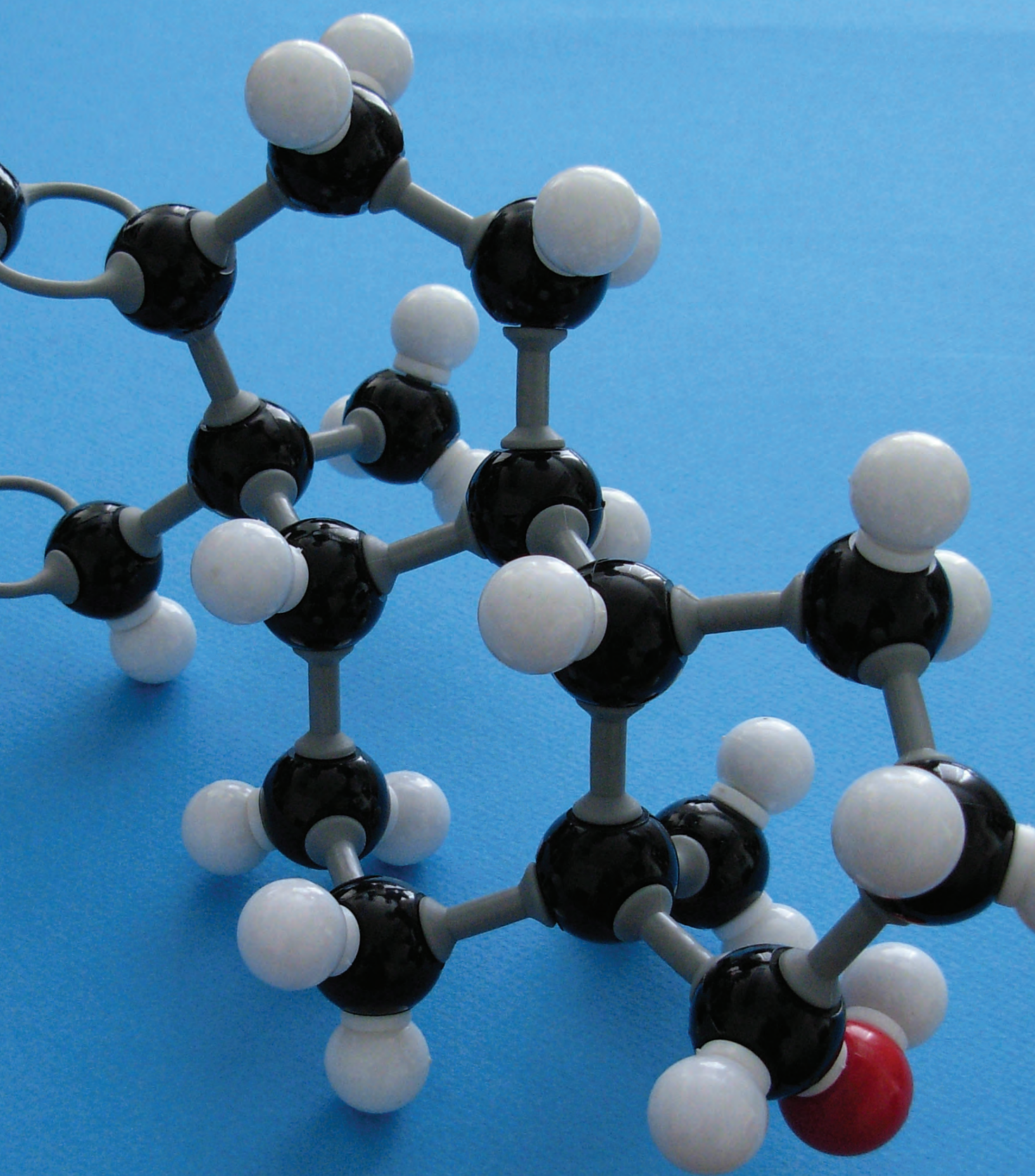
foreign debtor to administer its U.S. assets, as exemplified by bankruptcy proceedings concerning Qimonda AG.

Section V: Other Hot Issues

Milbank attorneys addressed several other hot issues in 2010. Chris Chalsen wrote in *Inside Counsel* about how the Supreme Court recently sent shock waves through the profession by granting *certiorari in i4i v. Microsoft* to review a Federal Circuit decision on a fundamental patent principle: the presumption of patent validity. Mark Scarsi was featured in *Inside Counsel and BNA's Patent, Trademark & Copyright Journal*, with his articles addressing such diverse issues as the political climate favoring patent reform, ethical issues arising in international IP practice, and tips for patentees planning to sue in the Central District of California, a growing hub for patent litigation. The issue of obviousness became hot again in 2010, and Milbankers were on top of it. Chris Chalsen wrote about the so-called “common sense” obviousness test for patentability, a concept that cropped up in *KSR* and is now starting to pervade Federal Circuit obviousness jurisprudence. Chris Gaspar presented on the latest guidelines to obviousness from the courts. Remedies also reappeared as a hot issue in 2010. Chris Chalsen presented at the IPO annual meeting about the emerging remedy of compulsory licensing, which for patentees may be the sum of all fears. In *BNA's Antitrust & Trade Regulation Report*, Jim Klaiber and Jeff Lesovitz also addressed compulsory licensing, particularly in patent misuse cases. Another emerging, if not alarming trend in 2010, was the filing of numerous *qui tam* actions for false patent marking. Chris Holm wrote about the risks and benefits of patent marking and current trend in false marking cases. Finally, Jim Klaiber delivered several presentations on business aspects of IP, including due diligence and licensing / settlement negotiations.



PHARMACEUTICALS AND BIOTECHNOLOGY



Considering The Impact Of New Legislation on Biologics In The US

By
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The Hatch-Waxman Act altered the competitive dynamics of the US pharmaceutical market in favour of generics by allowing them to rely on innovators' clinical trial data to show safety and efficacy, thereby avoiding the enormous time and expense associated with clinical trials. The Act also allowed generics to legally infringe for purposes of developing generic drugs and to mount early patent challenges. In return, some of the patent term lost in the regulatory approval process was restored to innovators and they were afforded exclusivity in certain circumstances to their clinical trial data for some period before generic applicants could rely on the data. Industry insiders have questioned whether the 'balance' struck by Hatch-Waxman has unduly favoured generics and has contributed to a general decrease in the innovative activity of the US pharmaceuticals industry. Against this backdrop, Congress this year enacted the Biologics Price Competition and Innovation Act (Biologics Act), which provides an abbreviated regulatory pathway for follow-on biologics (FOBs), or biosimilars. Comparing the Hatch-Waxman Act to the Biologics Act provisions may provide some insight into the possible effect of the latter on the future of biologics innovation in the US.

The Biologics Act is partially modelled after the Hatch-Waxman Act in allowing generic applicants to legally infringe for purposes of developing FOBs and in allowing applicants to mount early patent challenges. As with the Hatch-Waxman Act, innovators in return are afforded certain periods of exclusivity as incentives. Although the generic disclosure procedures under the Biologics Act are more complex than those under the Hatch-Waxman Act, basically the FOB applicant must disclose its application, a description of its manufacturing process and other information if necessary for the innovator to analyse the application. Like the Hatch-Waxman Act, the Biologics Act further incentivises generic entry by providing an exclusivity period for the first generic approved, so that a second generic applicant may not seek approval until the exclusivity period expires.

However, differences between small molecule drugs and biologics account for certain significant differences between the Hatch-Waxman Act and the Biologics Act. Small molecule drugs are often more readily made from chemical compounds synthesised on a large scale. Biologics are comparatively difficult to develop because they are generally more complex. Moreover, constructing

a manufacturing facility is typically more expensive and complicated. Recognising the substantially greater time and expense investment required to develop and manufacture biologic drugs, the Biologics Act provides for a greater data exclusivity period. Instead of a maximum of five years of data exclusivity under Hatch-Waxman, a biologics innovator may be allowed 12 years of exclusivity under the Biologics Act, regardless of whether any patents have expired before that time.

On the other hand, other differences in the Acts benefit the FOB manufacturer. For example, the Hatch-Waxman Act requires a generic active ingredient to be the same as the innovator active ingredient. In contrast, the Biologics Act provides some flexibility, recognising it may be difficult or impossible to exactly replicate biologics. Thus, the Biologics Act only requires an FOB to be “highly similar to the reference product notwithstanding minor differences in clinically inactive components”. Nevertheless, due to the complexity of biologics, even slight differences may have significant effects on safety and efficacy. As a

result, the Biologics Act requires that the applicant demonstrate there is “no clinically meaningful differences between the biological product in terms of the safety, purity, and potency of the product”. Unless waived by the FDA, biosimilarity must be supported by data from preclinical (analytical & animal) and human clinical studies. This means the default is that a biologics applicant must conduct at least some human clinical trials, rather than relying entirely on the innovator’s clinical data. This is different from the approval pathway for generic small-molecule drugs, which does not require any clinical trials for safety and efficacy but instead allows the applicant to rely entirely on the innovator’s clinical data. The FOB default requirement for additional clinical trials could prove significant as such studies could exceed four years. There are additional disadvantages to innovators under the Biologics Act. For example, unlike the Hatch-Waxman Act procedure, filing a patent infringement suit does not stay FDA’s approval of the FOB application. This is a significant boon to the FOB applicant.

The foregoing comparison between the Hatch-Waxman Act and the Biologics Act suggests some differences that may affect the ‘balance’ between innovators and generics. However, on the whole the Biologics Act does not seem substantially worse for innovators than the Hatch-Waxman Act. It is therefore possible that the Biologics Act may not engender the same criticisms as the Hatch-Waxman Act about unduly disadvantaging innovators and decreasing innovative activity. While the impact of the Biologics Act should be carefully monitored, for the time being it should not deter investor interest in the US innovator biologics industry.

Errol Taylor “impresses with his legal strategy, scientific insight and business acumen.” He is best known for his patent litigation work in the pharmaceutical and biotech fields, representing major names such as AstraZeneca and Merck.

– *Chambers USA 2010*

Was the Concern That *KSR* Was a Game-Changer Justified? Not for Chemical Cases Before the Federal Circuit

By
Fredrick M. Zullo
and
Anna Brook

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The authors argue that the “sea change” in decisions on obviousness after the U.S. Supreme Court’s *KSR* ruling did not occur, at least with respect to chemical compound patent challenges.

In the immediate aftermath of the U.S. Supreme court’s ruling in *KSR v. Teleflex*,¹ many thought there would be major changes in how courts analyze obviousness. Subsequent case law in the U.S. court of Appeals for the Federal Circuit shows that, at least for chemical patent litigation, *KSR* did not significantly alter the validity analysis. The touchstone continues to be “predictability.”

In litigation, courts recognize that unlike the mechanical arts, combinations and modifications of chemicals often produce unpredictable results, like drastic increases in potency or the ability to treat unrelated diseases. A showing of unpredictability (or unexpected

results) was a linchpin to preserving validity in chemical patent litigation pre-*KSR*, and that continues to be the case post-*KSR*.

KSR did not significantly change the factors considered when assessing obviousness under Section 103 of the Patent Act, 35 U.S.C. §103. Instead, a review of Federal Circuit case law shows that *KSR* only rejected a rigid application of the Federal Circuit’s “teaching, suggestion, or motivation” test (“TSM”) and reconfirmed that the Supreme court’s *Graham factors*² set out the appropriate framework for determining obviousness.³ These Supreme court enunciated factors were the basis for proper validity analysis prior to *KSR*, and remain so today.

KSR’s impact on chemical cases can be analyzed in two groups: (1) chemical compound patents (including enantiomer patent cases); and (2) formulation or composition patents (including combination patents).

Compound Patents

The Federal Circuit reviewed several chemical compound patents in the wake of *KSR*. While heeding *KSR*’s instruction to avoid a rigid application of the TSM test, the Federal Circuit

¹ *KSR International Co. v. Teleflex Inc.*, 550 U.S. 398, 82 USPQ2d 1385 (2007) (74 PTCJ 5, 5/4/07).

² *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 148 USPQ 459 (1966). These factors include the scope and content of the prior art, the differences between the prior art and the claims at issue, the level of ordinary skill in the art, and objective evidence of nonobviousness.

³ *KSR*, 550 U.S. at 406-407.

recognized that the unpredictable nature of the chemical arts impacts the obviousness analysis.

Both pre-KSR and post-KSR, obviousness inquiries in chemical compound cases tend to identify a “lead compound.” A “lead compound” is a short-hand way of referring to the closest prior art—again, a long accepted approach to analyzing validity. Post-KSR nonobvious rulings are primarily based on the lack of a prior art-based reason to either (1) select a specific lead compound (or compounds) or (2) modify the lead compound resulting in the claimed compound. Not surprisingly, these rationales supported decisions upholding validity pre-KSR as well. For example, in *Takeda v. Alphapharm*,⁴ the Federal Circuit confirmed that KSR does not prevent use of the TSM test, as long as the test is not rigidly applied. In the chemical arts, “normally a prima facie case of obviousness is based upon structural similarity, i.e., an established structural relationship between a prior art compound and the claimed compound.” But a prima facie case also requires “a showing that the prior art would have suggested making the specific molecular modifications necessary to achieve the claimed invention.”⁵

Whether or not referred to as a “teaching, suggestion or motivation” test, the law pre-KSR and post-KSR requires a reason (in the prior art) for making the modification. Thus, in *Takeda*, the court affirmed nonobviousness of a compound, the antidiabetic drug pioglitazone (ACTOS), that was structurally similar to a prior art compound (compound b) because there was no motivation—

Whether or not referred to as a “teaching, suggestion or motivation” test, the law pre-KSR and post-KSR requires a reason (in the prior art) for making the modification.

no reason—for a skilled person to select compound b as the lead compound, and nothing to suggest—no reason for—making the molecular modifications necessary to achieve the claimed compound. In fact, the court noted that prior art taught away from selecting compound b as the lead compound because it had toxic properties. The court’s analysis in *Takeda* focused on predictability as understood by persons skilled in the art and the reasons available in the prior art for making changes to the prior art to arrive at the invention. In short, the court used the same basic approach to address obviousness.

In *Ortho-McNeil v. Mylan*⁶ the court highlighted the need to consider the predictability of the art in question when making an obviousness determination, and the unexpected nature of the chemical arts as opposed to the mechanical apparatus of KSR. The court pointed out that the KSR obviousness standard presumes a finite and, in the context of the art, small or easily traversed number of options. But in *Ortho-McNeil*, the court found that although the compound topiramate

(Topamax) was structurally similar to prior art compounds, the patent at issue was not obvious because it taught a different use of the compound to treat an unrelated disease. The use of the compound to treat an unrelated disease was considered nonobvious, since “... the ordinary artisan in this field would have had to ... stop at that intermediate and test it for properties far afield from the purpose for the development in the first place (epilepsy rather than diabetes).”⁷

The court emphasized that a flexible application of the TSM test as contemplated by KSR assists the obviousness analysis by preventing inappropriate use of hindsight. The district court opinion was rendered before KSR, but the Federal Circuit found that there was no rigid application by the district court of the evidentiary requirements for obviousness and affirmed, confirming that KSR did not drastically alter the validity inquiry.

In *Eisai v. Dr. Reddy’s*,⁸ the Federal Circuit again acknowledged that unpredictability may well differentiate the chemical arts from the facts of KSR: “To the extent an art is unpredictable, as the chemical arts often are, KSR’s focus on these ‘identified, predictable solutions’ may present a difficult hurdle because potential solutions are less likely to be genuinely predictable.”⁹ In *Eisai*, the court affirmed summary judgment that a patent claiming rabeprazole (Aciphex), a proton pump inhibitor, was not an obvious modification of a prior art compound. Again, predictability was key: there was no discernible reason for a skilled artisan to modify the “lead” prior art

⁴ *Takeda Chemical Industries Ltd. v. Alphapharm Pty. Ltd.*, 492 F.3d 1350, 83 USPQ2d 1169 (Fed. Cir. 2007) (74 PTCJ 291, 7/13/07).

⁵ *Id.* at 1356.

⁶ *Ortho-McNeil Pharmaceutical Inc. v. Mylan Laboratories Inc.*, 520 F.3d 1358, 86 USPQ2d 1196 (Fed. Cir. 2008) (75 PTCJ 593, 4/4/08).

⁷ *Id.* at 1364.

⁸ *Eisai Co. v. Dr. Reddy’s Laboratories Ltd.*, 533 F.3d 1353, 87 USPQ2d 1452 (Fed. Cir. 2008) (76 PTCJ 413, 7/25/08).

⁹ *Id.* at 1359.

compound in a way that eliminated an element to which the compound's advantageous treatment property had been ascribed.

In *Procter & Gamble v. Teva*,¹⁰ the Federal Circuit affirmed the district court's decision that the patent claiming risedronate (Actonel) was valid. The court recognized the need to evaluate whether at the time of the invention, a skilled person had a reason to attempt to make the compound, and a reasonable expectation of success in doing so. Teva (the patent challenger) did not establish sufficient motivation (a reason) for a skilled person to synthesize and test the compound, or that there was a reasonable expectation of success. Relying on *Eisai*, the Federal Circuit once again explained that *KSR*'s focus on "identified, predictable" solutions may present a difficult hurdle because solutions in the chemical field are less likely to be predictable.¹¹

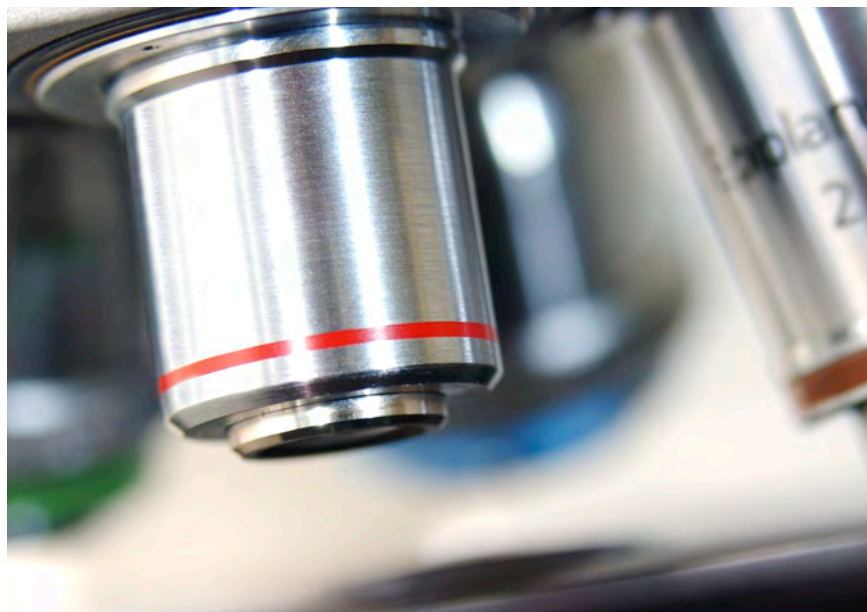
As would be expected, patent challengers succeed where sufficient evidence is presented to demonstrate reasons supported by prior art to modify the closest prior art to engulf the claimed compound. For example, in *Altana v. Teva*,¹² the Federal Circuit affirmed a district court's denial of Altana's motion for a preliminary injunction, ruling that Teva succeeded in raising a substantial question of obviousness of the patent directed to pantoprazole (Protonix). Teva (the patent challenger) identified a lead compound (the closest prior art) and then showed that there was motivation to modify that compound to obtain pantoprazole. The court found that Altana's own earlier patent identified a promising lead compound and that prior art provided a reason

and method to lower the compound's pKa to improve stability. The court noted that the prior art does not have to point to a single lead compound since that would give rise to a rigid test similar to the TSM test rejected in *KSR*. These facts supported a strong showing that a reason existed to modify the prior art to encompass the claims (even if the prior art reason for modifying differed from the inventive reason for making changes).

Of course, the burden of showing a substantial question of obviousness at the preliminary injunction stage is lower than the burden of showing clear and convincing evidence of invalidity at trial. After trial in *Altana*, a jury returned a verdict in favor of the patentee. The jury found that a skilled person did not have a reason or motivation to select either of two potential lead compounds, modify it to obtain pantoprazole, or have a reasonable expectation of success.¹³ The court denied a motion for a judgment as a matter of law, stating that defendants failed to establish a *prima facie* case of obviousness.¹⁴

Enantiomer Patents

Stereoisomers are compounds that contain the same constituent atoms and the same bonds between atoms, but have different spatial arrangements. An "enantiomer" is one of two stereoisomers that are mirror images of each other and are non-superimposable, generally explained by comparing the right and left hands. A "racemic mixture" or "racemate" contains equal amounts of both enantiomers. Because an enantiomer may sometimes make up a portion of a prior art racemic mixture, alleged infringers invariably argue that separating and testing the enantiomers would be obvious to a skilled person. The Federal Circuit cases pre- *KSR* and post-*KSR*, however, highlight consideration of time-tested factors when deciding the obviousness question: unpredictable and unexpected properties of the enantiomer over the racemate, and the ability to make the claimed enantiomers. Comparing the post- *KSR* Federal Circuit decisions—*Forest*, *Aventis* and *Sanofi*—helps



¹⁰ *Procter & Gamble Co. v. Teva Pharmaceuticals USA Inc.*, 566 F.3d 989, 90 USPQ2d 1947 (Fed. Cir. 2009) (78 PTCJ 92, 5/22/09).

¹¹ *Id.* at 996.

¹² *Altana Pharma AG v. Teva Pharmaceuticals USA Inc.*, 566 F.3d 999, 91 USPQ2d 1018 (Fed. Cir. 2009) (78 PTCJ 86, 5/22/09).

¹³ No. 04-2355 (JLL) (D.N.J., jury verdict Apr. 23, 2010).

¹⁴ No. 04-2355 (JLL) (D.N.J., July 15, 2010).

illustrate how the court analyzes these types of chemical cases, upholding validity in two cases while invalidating the patent in the third.

In *Forest v. Ivax*,¹⁵ the Federal Circuit affirmed the district court's pre-KSR decision maintaining validity for a patent relating to a substantially pure (+)- enantiomer of citalopram, used in the antidepressant drug Lexapro. Ivax argued that (+)-citalopram was obvious in light of racemic citalopram and descriptions of various techniques available to separate isomers from their racemates. Also, Ivax argued there was an expectation in the art that one enantiomer would be more potent than the other and therefore a reason existed for a skilled person to isolate the enantiomers. Forest argued that the difficulty of separating the enantiomers and the unexpected properties of the (+)-enantiomer (twice the potency of the racemate) supported nonobviousness.

The district court concluded that a skilled person would have been motivated to make a new compound rather than undertake the unpredictable task of separating the enantiomers, and would have no reasonable expectation of success. The court also found that none of the prior art references described the reactions claimed by the patent. The Federal Circuit agreed that the claims were not invalid, holding that the district court properly applied the *Graham* factors. The Federal Circuit opinion issued five months after, but did not cite, *KSR*.

In *Aventis v. Lupin*,¹⁶ the Federal Circuit reversed the district court and invalidated a patent directed to the blood pressure medication ramipril (Altace). The Federal

Circuit found that the prior art showed the immediate precursor of ramipril, its active stereoisomers, and how to isolate them, making a patent covering the similar active stereoisomers of ramipril obvious. Ramipril's structure contains five stereocenters, each of which can be in the "R" or "S" orientation. There was a prior art composition that included only the all-S (SSSSS) and SSSSR stereoisomers of ramipril (in other words the prior art was not free of all other isomers as required by the claims). It was also

Recent Federal Circuit and district court cases relating to combination patents recognize *KSR*, but it is likely that the outcome of the cases would have been the same prior to *KSR*.

known in the prior art that the all-S (SSS) stereoisomer of a related ACE inhibitor was 700 times more potent than the SSR stereoisomer. The court found this would have led a skilled person to expect that the all-S stereoisomer of ramipril would have a similar effect, noting that post-KSR: "It remains necessary to show some articulated reasoning with some rational underpinning to support the legal conclusion of obviousness, but such reasoning need not seek out precise teachings directed to the specific subject matter of the challenged claim."¹⁷

In *Sanofi v. Apotex*,¹⁸ the Federal Circuit considered the obviousness of an enantiomer patent relating to clopidogrel bisulfate (Plavix), used to treat or prevent blood-thrombotic events such as heart attacks and strokes. Unlike in *Aventis*, the court affirmed the district court's finding that the results of the separation of the enantiomers were unpredictable and not obvious. It was unexpected that one isomer would exhibit the desired characteristics without the negative side effects, while the other isomer had the negative side effects and not the desired activity. In addition, although there were several general methods for separating isomers, achieving the separation for the isomer in question required significant efforts because it was not known in advance which process would work. And, nothing in the prior art directed a skilled person to form the specific claimed salt of the enantiomer.

The court rejected Apotex's argument that separating the enantiomers and determining their properties was obvious and covered by *KSR*'s determination that a combination of familiar elements is likely to be obvious when it yields predictable results. The court emphasized that, unlike the *KSR* mechanical device, Sanofi did not concern a "combination of familiar elements."¹⁹

Formulation Patents

When considering formulation patents, the Federal Circuit again focused on the unpredictability of the chemical arts, and whether the prior art narrows the range of solutions to a finite and limited number that could be systematically tried.

¹⁵ *Forest Laboratories Inc. v. Ivax Pharmaceuticals Inc.*, 501 F.3d 1263, 84 USPQ2d 1099 (Fed. Cir. 2007) (74 PTCJ 557, 9/14/07).

¹⁶ *Aventis Pharma Deutschland GmbH v. Lupin Ltd.*, 499 F.3d 1293, 84 USPQ2d 1197 (Fed. Cir. 2007) (74 PTCJ 555, 9/14/07).

¹⁷ *Id.* at 1301 (internal quotation marks omitted).

¹⁸ *Sanofi-Synthelabo v. Apotex Inc.*, 550 F.3d 1075, 89 USPQ2d 1370 (Fed. Cir. 2008) (77 PTCJ 185, 12/19/08).

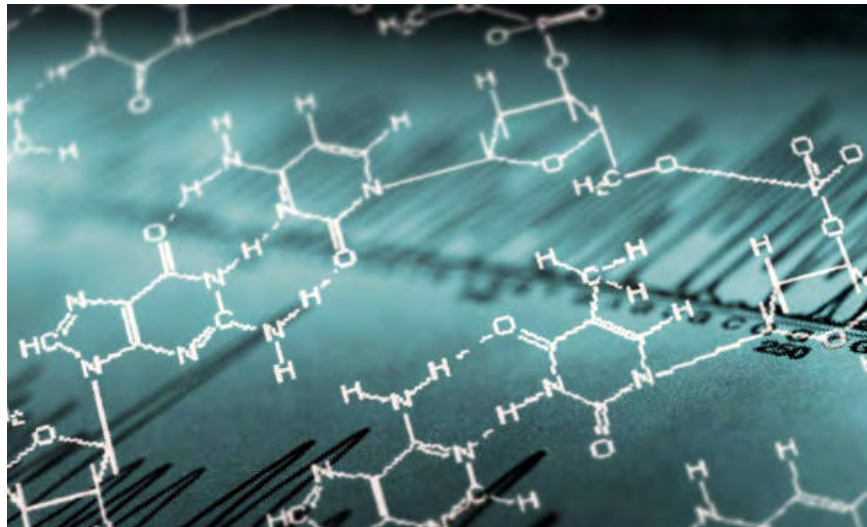
¹⁹ *Id.* at 1090.

In *Abbott v. Sandoz*,²⁰ the Federal Circuit considered patents relating to extended release clarithromycin formulations, marketed as Biaxin XL. Sandoz alleged the two patents at issue were obvious in view of certain references. Sandoz asserted that *KSR* significantly changed the obviousness analysis and that the district court did not give proper recognition to the changes when it granted Abbott's motion for a preliminary injunction pre-*KSR*.²¹

The Federal Circuit affirmed the preliminary injunction in part because the patentee established a likelihood of success in demonstrating nonobviousness. The court noted that the art was unpredictable, and the prior art did not narrow the range of solutions to a finite number that made it obvious to combine the references. The Federal Circuit emphasized that the obviousness inquiry should consider the nature of the science or technology at issue and that each case must be decided based on the characteristics and state of the particular field of technology.

In contrast to *Abbott*, in *Bayer v. Barr*,²² the Federal Circuit found that the prior art narrowed the list of possible solutions to a finite number and upheld a district court's obviousness ruling on a patent relating to drospirenone (Yasmin), an oral contraceptive. The court found there was a limited number of possible formulations and that it would have been obvious to deliver the micronized drug via a normal pill.

Bayer argued before the USPTO that micronizing a drug improved



its absorption, but led to increased isomerization in the stomach, which taught away from delivering the drug using a normal pill as opposed to an enteric coated pill. Enteric coated pills, however, reduce the drug's bioavailability and create patient-to-patient variation in the onset of therapeutic response to the drug. The district court held that under *KSR* it would have been obvious to a person of skill in the art to try a normal pill formulation. The Federal Circuit agreed, pointing out that a skilled person would be faced with two options for formulating the product: an enteric coated pill and a normal pill.²³ Judge Pauline Newman dissented from the opinion, stating that it was not obvious for persons of ordinary skill in the art to try a formulation that contravened conventional knowledge in the field and was not deemed reasonably likely to succeed.²⁴ The unanswered question here is whether there were other options or unsuccessful attempts to use formulations that would lead a person of ordinary skill away from using the "normal pill

formulation," making its choice less predictable.

In *Purdue v. Par*,²⁵ the Federal Circuit, in a nonprecedential opinion, affirmed the district court's ruling that patents relating to controlled-release tramadol formulations (Ultram ER) were invalid for obviousness. The court rejected Purdue's argument that a skilled person would not have selected tramadol for use in a once-daily formulation in view of a prior art patent listing tramadol as one of fourteen compounds for use in a controlled-release formulation to provide effective blood levels for a twenty-four hour period. The court agreed with the district court that the prior art patent and available knowledge would have led a skilled person to the claimed formulation through routine experimentation. The court did not discuss any evidence that would teach away from using tramadol in the formulation, and was not convinced by Purdue's secondary considerations of nonobviousness. The Federal Circuit did not cite *KSR*

²⁰ *Abbott Laboratories v. Sandoz Inc.*, 544 F.3d 1341, 89 USPQ2d 1161 (Fed. Cir. 2008) (76 PTCJ 921, 10/31/08).

²¹ The district court's original opinion issued before *KSR*. The court then requested additional briefing and argument and issued another opinion discussing *KSR*.

²² *Bayer Schering Pharma AG v. Barr Laboratories Inc.*, 575 F.3d 1341, 91 USPQ2d 1569 (Fed. Cir. 2009) (78 PTCJ 469, 8/14/09).

²³ *Id.* at 1350.

²⁴ *Id.* at 1350-1351.

²⁵ *Purdue Pharma Products L.P. v. Par Pharmaceuticals Inc.*, No. 2009-1553 (Fed. Cir. June 3, 2010).

²⁶ *KSR*, 550 U.S. at 415-416.

²⁷ *Id.* at 418.



in its opinion, but did consider the *Graham* factors.

Combination Patents

Recent Federal Circuit and district court cases relating to combination patents recognize *KSR*, but it is likely that the outcome of the cases would have been the same prior to *KSR*.

In *KSR* the Supreme court affirmed its “earlier instructions concerning the need for caution in granting a patent based on the combination of elements found in the prior art.” The court explained that the combination of familiar elements according to known methods is likely obvious when it only yields predictable results.²⁶ Thus, once again, before and after *KSR*, the main question with chemical

combination patents remains whether the combination of known elements produces an unexpected effect. Any other approach would eviscerate the large body of case law acknowledging that the mere fact that each element in a combination was known in the prior art does not by itself invalidate a patent.²⁷

In *Ortho-McNeil v. Teva*,²⁸ the Federal Circuit considered the validity of a reissued patent directed to a combination of tramadol and acetaminophen for use in prescription pain relief, sold under the name Ultracet. The court reversed the district court’s summary judgment of invalidity of certain claims of the patent, and affirmed judgment of invalidity of one of the claims.

In considering validity, the court distanced chemical patents from *KSR* by stating, “each case must be decided in its particular context, including the characteristics of the science or technology, the nature of the choices available to one skilled in the art, the specificity of the prior art, and the predictability of results in the area of interest.”²⁹

The court vacated the district court’s summary judgment of invalidity of certain claims of the reissue patent. The court credited expert testimony that prior art that disclosed a combination of tramadol, acetaminophen, and two other ingredients (the Flick patent) did not make the claims at issue obvious because interactions between tramadol and acetaminophen were poorly understood and unpredictable at the time, and it was not obvious what would happen if the two other ingredients were removed from the prior art example. Thus, the court recognized a material fact issue remained to be resolved, making summary judgment inappropriate.³⁰

However, the court found a claim that used the term “comprising” of tramadol and acetaminophen in a certain ratio obvious in light of Flick because “comprising” is an open-ended term that could include the other two materials (which in combination with tramadol and acetaminophen would include all the elements of the prior art). The court further determined that the difference between the ratio in the patent claim and in the prior art was too slight to preserve the claim’s validity.³¹

Judge Haldane Robert Mayer dissented, stating that the patent did nothing more than combine

²⁸ *Ortho-McNeil Pharmaceutical Inc. v. Teva Pharmaceuticals Industries Ltd.*, 344 Fed.Appx. 595, 93 USPQ2d 1125 (Fed. Cir. 2009) (78 PTCJ 564, 9/4/09).

²⁹ *Id.* at 598.

³⁰ *Id.* at 598-599.

³¹ *Id.* at 599-601.

³² *Id.* at 601-603.

two known pain relievers into one tablet and prior art already taught that the two ingredients could be combined for effective pain relief. Mayer explained that one of ordinary skill in the art at the time would have been motivated to remove the two other Flick ingredients because it was suspected they had negative effects, and that it was known that the combination of tramadol with other analgesics showed synergistic effects.³² The value of the surviving claims remains to be evaluated given this history.

While the Federal Circuit has not had the opportunity to review many chemical combination patents post-KSR, recent district court cases shed some light.

In *McNeil PPC v. Perrigo*,³³ the district court, while invalidating the claims at issue, addressed KSR at length, highlighting the Supreme Court's approval of the *Graham* factors, the rejection of a rigid TSM test, and the caution against relying on hindsight. The Federal Circuit affirmed without an opinion.³⁴

The patent at issue was directed to a combination of aluminum or magnesium hydroxide (an antacid) with famotidine (a histamine H₂-receptor antagonist) used in *Pepcid Complete*. The invention used impermeably coated famotidine, which otherwise degrades in stomach acid and has a bitter taste. Prior art reviewed by the court included references to a solid oral dosage form containing uncoated famotidine and an antacid, a method for coating various drugs (including famotidine) to mask their taste, and a combination of another bitter H₂ blocker and an antacid in a chewable tablet.

Plaintiff argued that the claimed

coated famotidine degrades more slowly than the uncoated form. The court, however, found the claims obvious because the prior art provided an independent motivation to coat famotidine to mask its bitter taste, regardless of its effects on degradation. Thus, consistent with KSR (and pre-KSR law), the court considered the teachings in the prior art and what would be obvious avenues of development for a person of ordinary skill in the art.

In *Sanofi-Aventis v. Glenmark*,³⁵ the district court denied defendant's motion for summary judgment of invalidity of a combination patent. The patent claims were directed to a combination of an angiotensin-converting enzyme inhibitor ("ACE inhibitor") and a calcium antagonist that Sanofi sells under the name Tarka.

Defendants alleged that ACE inhibitors, calcium antagonists, the combination of both, and their respective anti-hypertensive activities were known in the art at the time of the invention. They also pointed to the Tarka label which read "the antihypertensive effect of the combination is approximately additive to the individual components" to show that the combination did not produce unexpected results. Plaintiffs argued that it was not known how the two interacted and worked together to regulate blood pressure and that the duration and efficacy of Tarka is superior to the closest prior art combination.

The court denied summary judgment of invalidity recognizing the existence of questions of fact regarding the independent and collective properties of the compounds. The court also acknowledged that fact questions

existed regarding the scope of prior art disclosure, including whether prior art disclosing short term reduction of blood pressure made the use of the combination for the treatment of hypertension obvious.

Defendants subsequently received final FDA approval to market their ANDA product, and Sanofi sought a preliminary injunction and temporary restraining order. In its decision, the court discussed KSR's rejection of a rigid application of the TSM test, reviewed the cited prior art, and applied the *Graham* factors. The court denied the request for a preliminary injunction, finding that the patentee did not meet its burden of proof.³⁶ It remains to be seen how the court will ultimately rule on the merits of the case, but the court's reliance on the *Graham* factors confirms that the validity analysis of chemical combination patents was not altered by KSR.

Conclusion

As can be seen from the post-KSR Federal Circuit cases and district court cases, the validity inquiry applied by courts in chemical/pharmaceutical patent litigation has remained largely the same. KSR's warning against the rigid application of the TSM test supports a flexible inquiry. The validity inquiry balances the number of potential solutions, the innovative steps used to create the patented product, and what was obvious to a skilled person at the time. A review of post-KSR case law demonstrates that commentators who foresaw a "sea-change" in how cases would be analyzed appears to have been wrong at least with respect to chemical cases.

³³ *McNeil-PPC Inc. v. Perrigo Co.*, 516 F. Supp. 2d 238 (S.D.N.Y. 2007).

³⁴ 274 Fed.Appx. 899 (Fed. Cir. 2008).

³⁵ *Sanofi-Aventis Deutschland GmbH v. Glenmark Pharmaceuticals Inc. USA*, No. 07-CV-5855(DMC), 2010 WL 715402 (D.N.J. Feb. 19, 2010).

³⁶ *Sanofi-Aventis Deutschland GmbH v. Glenmark Pharmaceuticals Inc. USA*, No. 07-CV-5855 (DMC), 2010 WL 2428561 (D.N.J. June 9, 2010).

The Challenger Is Prepared, Are You? Strategies for Preparing to Enforce Patents Covering Pharmaceutical Products

By
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The authors provide advice to in-house counsel to prepare for patent litigation under Hatch-Waxman.

Your company's new product is doing very well, and sales are increasing. Management is looking to you, the chief IP counsel, for guidance on how to use the company's patents to protect the market for this important product. Data exclusivity may not exist or may be ending soon. You are sure that someone will try to sell a generic version and you want to be prepared to enforce your company's hard-won patents.

If your company's product is a small molecule product subject to a Hatch-Waxman Act challenge, your company will have only 45 days to decide whether to file a patent infringement action against the challenger in order to obtain the 30-month stay of Food and Drug Administration approval provided by the act. This deadline makes it especially important to be prepared if any challenge can be anticipated.

How do you figure out what potential challengers are doing? What issues are likely to come up in litigation? Set out below are a few key steps you can take to prepare management and key personnel for litigation that may determine the fate of this product.

Whether the litigation is triggered by the challenger's patent notice required by the Hatch-Waxman Act, or by potential competition from a similar biologic product in the same class as your company's product, one key to long-term success is thorough and effective early preparation.

Do Your Homework to Find and Assess Potential Challengers

The first place to start is making sure you have good information available on potential challengers. There are many good sources of market intelligence. Patents, published patent applications, and prosecution histories can yield particularly useful information about the direction a generic challenger is taking. You also can research potential challengers using press releases, corporate financial statements, and regulatory information such as clinical trial reports and FDA reports on Drug Master File, or DMF, applications.

Analyst reports are another fruitful source of information. A structured

program to monitor various sources of publicly available information can be very effective in piecing together disparate bits of information into a useful picture of the competitive landscape.

For example, bioequivalence clinical trial information can reveal the status of efforts to show that a potential competitor is ready for commercial sale. However, bioequivalence clinical trial information is often sketchy. For example, a trial may be identified only by a drug number code, without stating what the active pharmaceutical ingredient is. But this code may be mentioned in corporate news reports, financial statements, or publicly available articles and presentations. Drug codes may also be mentioned in patent applications and/or prosecution histories.

In addition, DMF applications will reveal which companies are planning to introduce an active pharmaceutical ingredient in the United States, long before a formulation is finalized. DMFs are listed on the FDA's website and updated frequently. When combined with information from private market research and sales people in the field, it is possible to make good guesses as to which competitors are planning to challenge your patents, and when. Often, a competitor will begin selling a formulation outside the United States, perhaps in India or Eastern Europe, which can signal a potential U.S. challenge.

If there are other brand drugs in the same class as your company's product, it would also make sense to monitor public information about challenges to those drugs, such as DMF filings, Abbreviated New Drug Applications, and associated FDA approvals, whether they are tentative or final. Challenges to related brand

Every patent is situated in its own area of technology, and cases can be won or lost based on the quality and preparation of experts.

drugs are often made by the same generic company, and its processes to make the related brand drugs may be very similar. Consequently, a challenge to a related brand drug may provide some insight into potential challenges to your company's product.

Preparing to Defend Your Hard-Won Patents from Infringement

Now that you've determined a challenge is likely, researched potential challengers, and hopefully obtained some information on likely generic formulations, the next step is to consider the defenses and claims that are likely to be raised. It may make sense at this point to line up outside counsel, clear conflicts, and set a budget to permit them to come up to speed on the key facts and to assist in considering the legal issues.

If the Hatch-Waxman Act applies to your company's product, it would make sense at this time to reconsider whether all of the right patents have been listed in the Orange Book. Orange Book listing decisions are important because under the Hatch-Waxman Act, a generic challenger that wants to sell a competing product before the patents expire must certify that any

listed patent is either not infringed, invalid, or unenforceable. The patent owner can then sue for infringement and, if it declines to file suit, the challenger may be able to seek a declaratory judgment.

In either case, litigation may be imminent. It is therefore better to consider listing decisions well in advance, rather than after a litigation is imminent or has been instituted. It is generally not necessary to list process patents but they can be asserted in litigation, so they should be considered in any pre-suit analysis. Use patents can be listed in certain circumstances, and should also be considered in analyzing which patents are listed in the Orange Book, as well as any infringement analysis.

There are many useful steps you can take in assessing how a litigation is likely to proceed. You should start by stepping back and considering what evidence will be necessary to prove infringement, and what potential validity challenges might be raised.

A first step might be to ensure a prior art search has been performed on any applicable patents and think about what related invalidity arguments are likely to be made. You can look at the prosecution history of the patents with a critical eye. What arguments would you make if you were the challenger, trying to limit or invalidate the patents? Consider whether you have doctrine of equivalents limitations, or whether you can assert a broad scope of equivalents. If such exercises are performed sufficiently in advance, they may reveal flaws in patent protection that can be corrected before litigation ultimately commences. For example, it may be possible to seek and obtain a patent continuation, reexamination, or reissue that can fix a gap in coverage or a potential invalidity issue.

You should also begin at this stage to ascertain the invention story and develop litigation themes supported by internal information that ultimately may be disclosed in discovery. While U.S. discovery can be very wideranging, it is usually possible to make reasonable estimates and forecasts about what documents and groups of documents will likely be relevant to the issues in the litigation and to start thinking about what documents will be produced.

It may make sense to conduct an initial review of those documents to anticipate particular issues that might come up. Because of the wide scope of discovery in U.S. cases, litigation and prosecution on related foreign patents often becomes evidence in a U.S. litigation. For that reason, your preparation should include if possible reviewing foreign evidence for statements and arguments that a challenger might assert against you in the United States.

It is usually possible to identify some people who are likely to be the subject of depositions. Certainly, inventors of the patents at issue are likely to be witnesses, if they are available. There may be people who are particularly important from a marketing or business perspective, and so you should consider making contact with those people in order to evaluate them as a potential witnesses.

Often, inventors can be excellent witnesses for the patent owner because they can provide a personal story of invention. Talking with people who have personal knowledge of the invention is also the best way to uncover any potential challenges based on alleged incorrect inventorship or alleged prosecution disclosure misstatements or omissions.



If likely deponents are in another country, it may make sense to think about what the legal requirements are for either bringing them for a deposition in the United States, or holding a deposition in their country of residence. And, of course, likely witnesses may be former employees. You can anticipate that the challenger will seek to contact former employees to determine whether or not they are willing to appear as a witness. It may make sense for you to find out what they will say beforehand, so that you can think about how that information is likely to play out.

In a pharmaceutical patent infringement action, one of the most important aspects of the evidence is expert testimony. Experts are almost always used in addressing validity issues like anticipation and obviousness under 35 U.S.C. §§ 102 and 103. Their testimony will also be necessary on any enablement or description issues under 35 U.S.C. § 112. And of course, experts are also critical for infringement.

Experts can also provide good advice on outside testing laboratories and/or internal testing protocols. So, where you know that a certain patent

is likely going to be in litigation, it often makes sense to try to identify and retain relevant outside experts early, even before a suit is filed. Every patent is situated in its own area of technology, and cases can be won or lost based on the quality and preparation of experts.

To check on how strong an expert will be in litigation, it may make sense to review relevant publications authored by a proposed expert, because these will likely be used in cross-examination. Likewise, other cases where the expert has provided an opinion or testimony may come up, and so it may make sense to obtain and review an expert's earlier opinions or testimony, if available.

Infringement is usually proven in part through the testing of samples of the challenger's product. In a Hatch-Waxman action, where the product is not yet on the market, the product to be analyzed for infringement is the product that is likely to be sold if the product is approved.

So, being able to test samples obtained from the challenger which may have been submitted to the FDA is very important. A challenger may provide these samples after its notice letter but before the 45-day deadline to secure a 30-month stay and, depending on the circumstances, you may be expected to have evaluated those samples before filing suit.

This leaves only a narrow window to complete any pre-suit testing, so it may make sense to try and line up relevant testing capability beforehand. That testing can be done by outside

experts, outside testing laboratories or, with permission from the challenger, in-house technical experts.

Early research and consultation with outside counsel will make the process smoother and lead to a more effective defense.

In any event, it will be important to have experts and testing capabilities ready to hit the ground running when a notice letter and samples come in. In fact, it may be possible and desirable to get a head start by obtaining samples of products containing the same active ingredient being sold by the challenger in foreign markets. These foreign samples, while not necessarily the same as U.S. samples, may provide some insight into the issues that will be encountered in a U.S. litigation.

Another important issue to consider is where an action is likely to be brought. Think about where potential defendants are likely to be found, and then what courts would be considered good ones to hear the case. For pharmaceutical patent litigation, the U.S. District Court for the District of New Jersey is a popular place to bring cases because of the number of pharmaceutical

companies in that state and the experience of the federal judges in the district. There are other districts that are known for having faster dockets, however, and the speed of the court may be a concern. Other factors to consider in deciding where to bring an action include the location of the likely witnesses, and whether subpoenas will be necessary in order to obtain their testimony at trial.

New Jersey has joined other districts and adopted patent-specific rules that can accelerate Hatch-Waxman patent litigation. These rules require that the generic challenger's Abbreviated New Drug Application be produced very promptly, before the initial scheduling conference, and that infringement and validity contentions be exchanged within two months of the initial scheduling conference.

These rules are similar in that respect to rules in the Eastern District of Texas and the Northern District of California. Preparation is arguably even more important in those courts, where the rules further require a plaintiff to present its claim construction and other key positions quite early in the case.

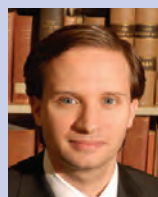
Conclusion

Even before a specific challenge is received, prudent in-house counsel can do a lot to get ready for challenges to the patents protecting their company's key products. Early research and consultation with outside counsel will make the process smoother and lead to a more effective defense.

Implications of 'Ariad' for Describing Biological and Chemical Inventions

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To patent an invention you must describe it. While that task may be more difficult for biological and chemical inventions, the U.S. court of Appeals for the Federal Circuit has confirmed that the patent laws require no less for such inventions than any other.

On March 22, 2010, the Federal Circuit released its much anticipated en banc opinion in *Ariad Pharmaceuticals Inc. v. Eli Lilly & Co.*¹ At issue was whether 35 U.S.C. § 112's first paragraph contains a written description requirement separate from the enablement requirement and, if so, the scope and purpose of that requirement. The opinion addressed a number of hotly disputed issues about the written description requirement and has important implications for patent owners, particularly those in the chemical, biotechnology and pharmaceutical industries.

Ariad owned a patent for a method for interfering with the expression of certain genes that are responsible for the harmful symptoms of certain diseases. The patent included genus claims that purported to cover all molecules capable of reducing gene expression through the disclosed method. Ariad sued Lilly alleging that its products infringed its patent.

At trial in the District of Massachusetts, the jury found Ariad's patent valid and infringed. On appeal, the Federal Circuit reversed and held the patent invalid for lack of written description. Ariad petitioned for a rehearing en banc on the ground that the court misinterpreted § 112's first paragraph as having a separate written description requirement. In an effort to resolve over a decade of uncertainty on this issue, the court agreed to reconsider the panel opinion.

Background

At the heart of *Ariad* was the statutory provision designed to uphold the quid pro quo that underpins patent law. Inventors are granted the exclusive right to make, use, and sell their invention in exchange for full disclosure of their invention. This centuries-old bargain is meant to promote innovation by providing inventors with an incentive to develop their ideas while ensuring that the public is able to understand and build upon them.

Specifically, § 112 states in relevant part: "The specification shall contain a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise, and exact terms as to enable

¹ No. 2008-1248, slip op. (Fed. Cir. March 22, 2010).

any person skilled in the art to which it pertains...to make and use the same...”

The controversy over the content and scope of §112 has attracted renewed interest ever since the Federal Circuit’s decision in *Regents of the University of California v. Eli Lilly & Co.*² In that case, the court confronted a patent that claimed a broad genus of synthetic DNA sequences that purported to encode insulin molecules of many different species. Such patent claims that cover a broad genus of DNA sequences are common in biotechnology because researchers often discover a novel, useful, and non-obvious functional encoding relationship between a certain type of DNA and a class of proteins before identifying the specific DNA molecules and/or corresponding proteins.

In *Eli Lilly*, the court held that such claims fail to meet the written description requirement because they provide “only a definition of a useful result rather than a definition of what achieves that result.”

The court has also grappled with this issue in subsequent cases. In *University of Rochester v. G.D. Searle & Co. Inc.*, the Federal Circuit affirmed the lower court’s summary judgment of invalidity for lack of written description because the pharmaceutical method claims at issue were not supported by disclosure of the compounds necessary to achieve the therapeutic result.³

In *Enzo Biochem Inc. v. Gen-Probe Inc.*, which involved claims to a broad genus of nucleotide sequences useful in bacterial screening, the Federal Circuit addressed the content of

‘Ariad’ is significant because it clarifies the written description standard and provides some guidance to its application.

the distinct written description requirement.⁴ The court held that the patentee must do more than simply include the claim language in the original specification. Furthermore, the court elaborated on its earlier “possession” standard of the written description requirement, stating that possession alone is not always sufficient to satisfy §112.

The court’s failure to clearly articulate a standard for written description distinct from enablement led to strong dissents by Judges Randall R. Rader, Richard Linn, and Arthur J. Gajarsa, as well as scholarly criticism, thus setting the stage for rehearing of *Ariad*.⁵ The primary question before the court was whether §112 contains two separate disclosure requirements: one to describe the invention and another to enable it.

The Decision

In a 9-2 decision, the Federal Circuit held that §112 does in fact contain a distinct written description requirement. The court’s reasoning was based on statutory construction and the policy that “[e]very patent must describe an invention.” The court also found support in Supreme court precedent dating back to 1938,

which articulated such policies and applied §112 in a manner consistent with the existence of a separate written description requirement.

The Federal Circuit also reconsidered a test it had developed in earlier cases that inquires whether the written description is sufficient to prove the inventor’s “possession” of the invention. The court recognized that “[t]he term ‘possession’...has never been very enlightening” and emphasized that “the hallmark of written description is disclosure.”

The court clarified that “possession” means “possession as shown in the disclosure” because “the test requires an objective inquiry into the four corners of the specification from the perspective of a person of ordinary skill in the art.”

In addition, the court confirmed that whether a patent complies with §112 is a question of fact. Finally, the Federal Circuit reiterated that actual examples or reduction to practice outside the specification are neither required nor sufficient; rather, the specification determines the sufficiency of the written description.

The majority opinion is also partly based on the principle of stare decisis—that holding the written description and enablement requirements are one would overturn longstanding law and thus frustrate the expectations of the inventing community. The court reasoned that such a significant change is best left to Congress.

The opinion also addressed the application of the written description requirement to original versus amended claims. *Ariad* argued that if a separate requirement exists, it is limited to establishing priority.

² 119 F.3d 1559 (Fed. Cir. 1997).

³ 375 F.3d 1303 (Fed. Cir. 2004).

⁴ 323 F.3d 956 (Fed. Cir. 2002).

⁵ Lawrence T. Kass & Nathaniel T. Browand, “Is There a Written Description Requirement After All?” IPLaw360, New York, Dec. 11, 2009.

By extension, *Ariad's* view was that the written description requirement does not apply to original claims because they are included in the original disclosure and thus fulfill the objective of establishing priority.

As it did in *Enzo*, the circuit court rejected the distinction between original and amended claims, finding nothing in the language of the statute to support it. Furthermore, the court explained that such a narrow interpretation of the written description requirement would betray the policy of ensuring that the inventor actually invented what is claimed. Drawing on its case law regarding genus claims in biotechnology, the court reasoned that a robust written description requirement prevents an applicant from monopolizing a desired result without explaining how that result can be achieved.

The court explained that the written description requirement can be met through disclosure of a representative number of species within the genus or structural features shared by all members of the genus such that one skilled in the art can identify them.

In addition, the species within the genus must be defined with sufficient precision to distinguish them from those outside the genus, and this may be done by formula, chemical name, and physical or other properties. Finally, when the science supports an inference of structure from function, functional claim language can satisfy the written description requirement.

Having reaffirmed its written description doctrine, the circuit court found that *Ariad's* claims were invalid. Applying the analogous *Rochester* case, the court held that *Ariad's* method claims failed to disclose

The primary question before the court was whether §112 contains two separate disclosure requirements—one to describe the invention and another to enable it.

specific molecules that inhibited that expression of the targeted gene.

Indeed, the specification did not disclose a single molecule capable of achieving the claimed methods, and *Ariad's* reliance on three broad classes of molecules could not satisfy the written description requirement.

In addition to the majority opinion, *Ariad* included a separate opinion, a concurring opinion, and two dissenting opinions. In her separate opinion, Judge Pauline Newman supported the outcome reached by the majority, but suggested that the case could have been resolved on the basis of §101 because *Ariad's* methods were merely scientific discoveries, which are not patentable subject matter. While joining the majority on its interpretation of §112, Judge Gajarsa was not convinced that the written description requirement serves much purpose beyond policing priority.

In dissent, Judge Rader argued forcefully that the language of the statute only supports one requirement under §112—enablement—and that the majority incorrectly interpreted the Supreme Court cases on which

it relied. Finally, Judge Linn's dissent took issue with the majority for failing to advance a workable written description text.

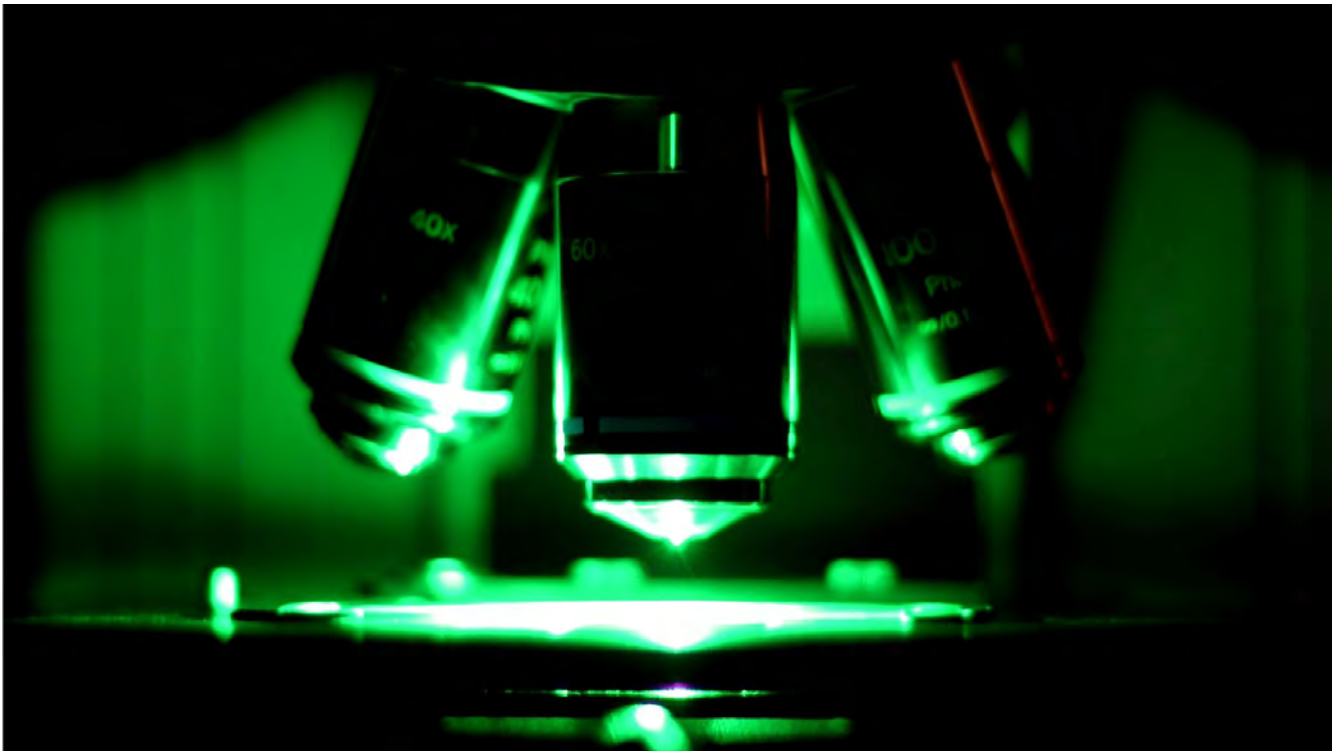
Implications

Much was at stake in the *Ariad* case, particularly for inventors in the biotechnology and pharmaceutical industries. While the majority opinion and vast majority of amicus briefs devote considerable effort to whether the written description requirement is distinct from enablement, *Ariad's* legacy is not so limited.

Instead, *Ariad* is significant because it clarifies the written description standard and provides some guidance to its application. The Federal Circuit distanced itself from its earlier "possession" test and made clear that the sufficiency of the written description is assessed based on the "four corners of the specification."

Based on the court's repeated references to genus claims and its biotechnology and pharmaceutical case law, the majority was most concerned about protecting the public from applicants who claim inventions that are still too uncertain. In keeping with patent law's quid pro quo, applicants must ensure that their specifications not only claim a desired result, but also provide sufficient information to demonstrate how that result is achieved.

The decision provides additional guidance to inventors and patent practitioners. Specifically, when claiming a genus, patent applicants should ensure to identify and describe as many species as possible. There is considerable flexibility in terms of meeting this standard including disclosure of the



chemical name, formula, physical properties, structure-function inferences, biological deposits, etc. Since the sufficiency of the written description is a factual inquiry, the most appropriate form of disclosure will depend on the circumstances of each case, particularly the technology involved.

The circuit court's clarification of "possession" is likely to have implications for patent litigation as well. A corollary of the court's statement that the written description

is assessed objectively based on the content of the specification is that extrinsic evidence may be unable to cure a disclosure that is lacking under §112. Thus, *Ariad* may provide accused infringers with an additional weapon for invalidating patents asserted against them.

Ariad will likely be seen as a setback for research institutions like universities, which have increasingly sought patents over the last few decades as a means of commercializing their discoveries.⁶

As was the case in *Ariad*, institutional research may not progress far enough to allow such applicants to satisfy the written description requirement, through, for example, the precise description of species. Consequently, it may be more difficult for these members of the inventive community to acquire patents and use them as a source of funding.

Despite two dissents, the separate written description requirement will likely be a fixture of U.S. patent law for the foreseeable future.

⁶ Abigail Rubenstein, "'Ariad' Ruling Bolsters Written Description Requirement," IPLaw360, New York, March 23, 2010.

The Biosimilar Ballet: Patent Litigation Under The 2010 Health Care Reform Act

By
Arie M. Michelsohn

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Arie M. Michelsohn

Prologue: Patent Litigation as an Incentive to Develop Biosimilar Drugs

The 2010 Health Care Reform Act brought not only insurance reform, but also added new subsections (k) and (l) to the biologics licensing statute, creating an abbreviated regulatory pathway to enable a generic, or “biosimilar,” biologics industry for the first time. (Title VII of the 2010 Health Care Reform Act creates a new biosimilars regulatory

pathway by amending the biologics licensing statute, §351 of the Public Health Services Act (“PHSA”), to add a new, “subsection (k),” codified at 42 U.S.C. §262(a)(1)(A)(k) et seq.)

Central to this pathway is a patent litigation scheme as an incentive for biosimilar development. (Codified as subsection (l) of the biologics licensing statute, 42 U.S.C. §262(a)(1)(A)(k) et seq.) The scheme, outlined in subsection (l), comprises a multi-stage, highly choreographed,

Subsection (l) Patent litigation arising from biosimilar applications

	Statutory Provision 42 U.S.C. § 262(a)(1)(A)(l)–	General Content
After filing	(l)(1)	Statutory protective order governing SSKA provision of confidential information to RPS.
Four-Step	(l)(2)	Requirements for submission of confidential information by SSKA to RPS 20 days after FDA acceptance of SSKA application.
	(l)(3)	Requirements for sequential exchange of detailed factual and legal information between RPS and SSKA regarding product and process patents covering the biosimilar drug, over the course of 180 days.
	(l)(4)	Requirement for good-faith negotiations between SSKA and RPS for up to 15 days to agree on which, if any, patents will be litigated in the “immediate” (subsection (l)(6)) phase (“(l)(4) patent list”).
Tango	(l)(5)	Procedure to establish which, if any, patents will be litigated in the “immediate” (subsection (l)(6)) phase, if the parties cannot agree (“(l)(5) patent list”).
	(l)(6)	“IMMEDIATE” PATENT LITIGATION: Requires RPS to file lawsuit on any (l)(4) or (l)(5) list of patents within 30 days; requires SSKA to notify FDA of complaint; and requires FDA to publish such notice in the Federal Register.
INTERMISSION	(l)(7)	Procedure for patents issued or licensed after RPS has provided its initial patent list (under (l)(3)) to SSKA; requires vetting of such patents pursuant to (l)(3).
Before Marketing	(l)(8)	“PRELIMINARY INJUNCTION” PATENT LITIGATION: Requires SSKA to notice RPS 6 months (180 days) prior to commercial marketing; RPS permitted to bring PI action with respect to any (l)(3) patents not on (l)(4) or (l)(5) patent lists.
Jig	(l)(9)	Prohibits either party from bringing a DJ action until (l)(8) applies, if SSKA gives RPS the information required under (l)(2); permits RPS to bring DJ action if SSKA does not take certain other required actions under the litigation scheme.

Overview of subsection (l) of the new biosimilars legislation (codified at 42 U.S.C. §262(a)(1)(A)(l) et seq.), which sets forth a dual-phase patent litigation scheme for resolving patent disputes arising from the filing of a subsection (k) (biosimilar) application. The references on the left of the Figure correlate to the ballet metaphor in the text.

and improvisational series of interactions between a biosimilar applicant under subsection (k) (called the “subsection (k) applicant” (“SSKA”)), and the innovator drug company that owns the approved application for the corresponding “reference product” (the “reference product sponsor,” or “RPS”).

The complexity of the scheme (which is loosely based on, but much more complicated than, the Hatch-Waxman Act that incentivized development of generic, small-molecule drugs beginning over 25 years ago) appears, at least at first glance, to rival three-dimensional chess. This article provides a guide through the complexity of the new biosimilars litigation scheme, using the metaphor of a ballet.

SiSKA & RiPS: A Strategic Ballet, in Three Acts

By: The United States Congress, March 23, 2010

Cast of Characters

SiSKA, the follow-on filer (the so-called “subsection (k) applicant”), who has asked FDA to approve her application to market a biosimilar drug pursuant to the new subsection (k) of the biologics licensing act;

and

RiPS, her counterpart in this drama, the innovator who is the owner, or sponsor, of the reference product SiSKA wants to copy and sell (the “reference product sponsor”). (Those who exclusively license RiPS and retain litigation rights may also join in the ballet, but as they typically are aligned with RiPS, they are omitted here for simplicity.)

The ballet of SiSKA and RiPS takes place in three stages, or Acts, called *The Four-Step, The Tango, and*

The Jig. The overall scheme is illustrated in Figure 1, and described further, below.

ACT I: The Four-Step

[Subsections (l)(1-3)]

The choreography of Act I is illustrated in Figure 2A, and may be described as follows:

Act I begins when the FDA accepts an application filed by SiSKA. The statute does not define a time period during which the FDA must accept a filed application, which could lead to some delay in the start of the show. However, within 20 days of such acceptance by the FDA, SiSKA and RiPS must begin their four-step dance, as required under subsections (l)(2) and (3) of the statute:

Virtually, in Their Respective Offices

SiSKA: Dear RiPS, pursuant to subsection (l)(2) of the new biosimilars legislation, here is the

biosimilar application I filed with the FDA, including all its confidential information. I am also giving you any confidential information I consider additionally necessary to inform you of how my biosimilar product is made. You may ask me for more information, and I may give it to you if I want to. Of course, you understand that all of the confidential information is provided under the strict confidentiality provisions of subsection (l)(1), which requires that it only be used by a limited number of your outside and in-house counsel and only for the purpose of determining whether I infringe any of your patents, and that your failure to respect this confidentiality will cause me irreparable harm.

Within 60 days, RiPS must respond:

RiPS: Thank you, SiSKA. Here is my list of patents pursuant to subsection (l)(3)(A) that I believe you would

Act I: The Four-Step

	Time	Section 42 U.S.C. § 262(e)(1)(A) ...	Actions
Step 1 SSKA (l)(2) Information	20 Days after FDA accepts SSKA Application	(l)(1) & (2)	<p>SSKA must provide RPS</p> <ul style="list-style-type: none"> the biosimilar application; and any other information SSKA believes necessary to determine how the proposed biosimilar product is made. <p>SSKA may provide additional information.</p> <p><small>(Confidential information is provided subject to the provisions of the statutory protective order under subsection (l)(1).)</small></p> <p><small>FAILURE TO PROVIDE RPS WITH THE ABOVE PERMITS RPS TO BRING DJ ON ANY PATENTS COVERING SSKA PRODUCT (SUBSECTION (l)(3)(C)).</small></p>
Step 2 RPS (l)(3)(A) Lists	60 Days after receipt of SSKA (l)(2) Information	(l)(3)(A)	<p>RPS must provide SSKA</p> <ul style="list-style-type: none"> a list of patents RPS believes would be infringed by SSKA product; and a list of patents RPS offers to license.
Step 3 SSKA (l)(3)(B) Reasons	60 Days after receipt of RPS (l)(3)(A) Lists	(l)(3)(B)	<p>SSKA must provide RPS</p> <ul style="list-style-type: none"> detailed reasons why each claim in each patent on RPS (l)(3)(A) Lists is not infringed, and why those and any other patents that SSKA may identify are invalid and/or unenforceable; and a response to RPS offer to license.
Step 4 RPS (l)(3)(C) Reasons	60 Days after receipt of SSKA (l)(3)(B) Reasons	(l)(3)(C)	<p>RPS must provide SSKA</p> <ul style="list-style-type: none"> detailed reasons why each claim in any new patent identified in SSKA (l)(3)(B) Reasons is infringed; and a response to SSKA statements concerning invalidity/unenforceability.

Overview of the four-stage process of detailed factual and legal information exchange between the subsection (k) applicant (SSKA) and the reference product sponsor (RPS) beginning 20 days after the FDA accepts the SSKA application, pursuant to subsections (l)(1)-(3) of the new biosimilars legislation.

infringe if you made, used, sold, offered for sale, or imported your proposed biosimilar product. Also, I give you my list of which of those patents I would be willing to license to you.

Within 60 days, SiSKA must respond:

SiSKA: Dear RiPS, pursuant to subsection (l)(3)(B), here are my detailed factual and legal reasons on a claim-by-claim basis why I believe, with respect to each of the patents on your list, the patent is not infringed, invalid, and/or unenforceable. I also respond to your kind licensing offer. And finally, I list those patents that I want to, which you did not list, and which I believe would be infringed by making, using, selling, offering for sale, or importing my biosimilar product, and describe the factual and legal reasons why I believe, on a claim-by-claim basis, that those patents are invalid and/or unenforceable.

Within 60 days, RiPS must respond:

RiPS: Thank you, SiSKA. Pursuant to subsection (l)(3)(C), here are my detailed factual and legal reasons why I believe, on a claim-by-claim basis, that each new patent you identified would be infringed by making, using, selling, offering for sale, or importing your proposed biosimilar product. I also provide my response to your statements on invalidity and/or unenforceability.

The curtain then closes on Act I, each of the principals with the other's lists and contentions in hand.

Act II: The Tango

[Subsections (l)(4) & (5)]

The choreography of Act II is illustrated in Figure 2B, and may be described as follows:

Act II unfolds as an improvisational, strategic duet between SiSKA and RiPS,

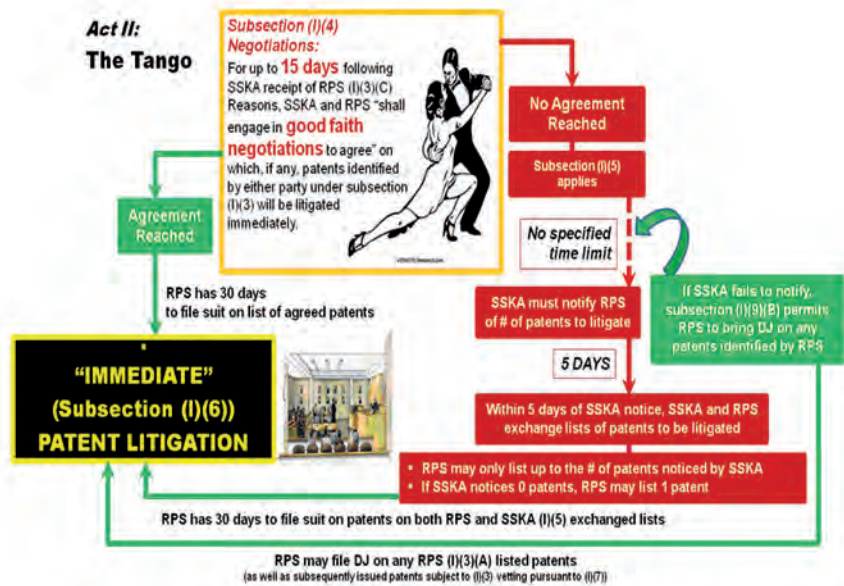
once they have shared their detailed contentions on patents. For 15 days after SiSKA receives RiPS' response under (l)(3)(C), the statutory ballet requires that the two principals "shall engage in good faith negotiations to agree" on which, if any, patents exchanged in the Act I Four-Step will be litigated immediately, pursuant to subsection (l)(6) of the statute. If they cannot agree, they must engage in a card-game power-dance to determine the final outcome. The suspense of the interactions suggests the tango metaphor.

In a Conference Room

If SiSKA and RiPS agree within 15 days on which patents to litigate immediately, they prepare what may be called an "(l)(4) list" of patents. Those patents on the (l)(4) list will be litigated "immediately," pursuant to subsection (l)(6) of the statute.

If SiSKA and RiPS do not agree within the prescribed 15-day

period, however, they must engage in the card-game power-dance of subsection (l)(5). Under subsection (l)(5)(A), SiSKA "shall notify" RiPS of the number of cards she will play: the number of patents she will list during the required, subsequent, list-exchange with RiPS that must occur within five days of her notification. If SiSKA fails to notify RiPS, however, then RiPS may bring a declaratory judgment action against SiSKA, pursuant to subsection (l)(9)(B), on any patents listed by RiPS during the Four-Step. (Subsection (l)(5) does not provide a time limit for SiSKA's notification; and subsection (l)(4)(B) simply states that if the parties fail to reach agreement within 15 days, the provisions of (l)(5) shall apply. Presumably, then, given the tight schedule otherwise provided, declaratory judgment jurisdiction under (l)(9) would commence unless SiSKA notifies RiPS promptly, although there may be some ambiguity as to the timing involved.)



Overview of the negotiation process between SSKA and RiPS according to subsections (l)(4) & (5) of the new biosimilars legislation, culminating in "immediate" patent litigation pursuant to subsection (l)(6).

Upon receipt of SiSKA's notification, SiSKA and RiPS must each give the other a list of patents that each, respectively, wants to litigate immediately (these may be called "the (I)(5) lists"). RiPS, however, may not list any more patents than the number identified by SiSKA in her notification. If, however, SiSKA identified zero patents, SiSKA may list one patent. Upon the exchange of their (I)(5) lists, RiPS then must sue SiSKA within 30 days, if at all, on any patents on either of those lists.

Thus, the outcome of the Tango can result in "immediate" litigation of at least one patent, at RiPS' discretion; but at most, one patent, unless SiSKA desires otherwise.

INTERMISSION

Any other patents identified by the principals during a Four-Step and not included on either the (I)(4) or (I)(5) lists generated during the Tango cannot be litigated until six months before commercial marketing of SiSKA's drug. At that point, at RiPS' discretion, SiSKA and RiPS may perform their final litigation dance, the Jig of Act III. The length of the intermission may depend on a variety of factors, including the length of FDA approval procedures, whether a biosimilar product is eligible for market exclusivity (which could cause a long intermission when the biosimilar application is filed relatively early in a reference product's data exclusivity period), and whether a reference product is ineligible for data exclusivity (which could cause a short intermission when FDA approval of the biosimilar's data package occurs relatively quickly).

Act III: The Jig

[Subsection (I)(8)]

The choreography of Act III is illustrated in Figure 2C, and may be described as follows:

Act III begins when SiSKA notifies RiPS six months (180 days) prior to commercial marketing of her biosimilar drug, which she must do pursuant to subsection (I)(8)(A) of the new biosimilars statute.

In Court

Upon receiving notification from SiSKA of her intent to market, RiPS may initiate the Jig by bringing a preliminary injunction action against SiSKA at any time during the six months before commercial marketing begins. RiPS may assert in this action any patents previously identified by either RiPS or SiSKA in a Four-Step,

but not included on any list subject to "immediate" litigation following the Tango. (In technical terms, RiPS may sue SiSKA on any patent vetted under (I)(3) or (I)(7) and not included on any lists generated under (I)(4) or (I)(5).)

Subsection (I)(8) further provides that once RiPS initiates such a preliminary injunction action, the principals "shall reasonably cooperate to expedite such further discovery as is needed" in conjunction with the action. The relatively brief, six-month interval, during which RiPS may bring his action, and the explicit, statutory, requirement for expedited discovery in such an action, suggests that when brought, it will cause a frenzy of litigation activity to vet issues of infringement, validity, and enforceability, even for the well-prepared (hence, the Jig metaphor).

Act III: The Jig



Overview of the final stage in the patent litigation scheme according to subsections (I)(7) & (8) of the new biosimilars legislation, requiring SSKA to notice RPS 180 days prior to commercial marketing, and permitting RPS to bring a DJ action during that time on patents on (I)(3) lists that were not previously listed under (I)(4) or (I)(5).

The frenzy likely would be particularly fierce when the parties previously do not agree to vet substantially the patent issues addressed during the “immediate” (after filing) phase of the litigation scheme.

In any event, whether SiSKA and RiPS choose to vet their patent differences following the Tango, or in the later Jig (or both), when the Jig stage of the biosimilar patent litigation scheme is over, then the time for biosimilar patent litigation over SiSKA’s drug, as it were, is up.

Epilogue: Preparing for a Plethora of Possibilities

Taken together, the byzantine features of the new biosimilars litigation scheme create a strategic, improvisational dance between the biosimilar applicant (SSKA), and the innovator-patentee (RPS). New subsection (l) of the biologics licensing statute defines the parameters

of information exchange, negotiation, and gamesmanship that choreograph this dance. The outcomes of the dance are further influenced by the data and market exclusivity provisions of new subsection (k). The dance will require numerous, detailed, and rapid strategic maneuvers once a biosimilar application is filed, which, in turn, will require adequate and substantial advance preparation. The dance can result in numerous permutations of scope and timing, and the ensuing litigation will be outcomedeterminative on substantially all patent issues related to biosimilar drugs in the U.S.

If they haven’t already, SiSKA and RiPS should start limbering up now.

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SOFTWARE AND BUSINESS METHODS



Supreme Court Invalidates Patent on Hedging Risk But Leaves Door Open for Less “Abstract” Business Method

By
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and
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The Hedge Fund Law Report.



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On June 28, 2010, the U.S. Supreme Court held a patent directed to a series of steps for hedging risk in commodities trading invalid as not being drawn to statutory subject matter. While the Supreme Court affirmed the Federal Circuit Court of Appeals’ decision that the patent was invalid, the Supreme Court did instruct the Federal Circuit to fashion additional tests for patentable subject matter based on the Supreme Court’s broad and somewhat antiquated principles.

Prior Law and USPTO Practice

Before the Supreme Court’s June 28 decision in *Bilski v. Kappos*, if a financial services company wanted a patent on a so-called “business method,” it had to make sure the patent’s claims were “tied” to a “particular” machine or performed a physical or chemical “transformation.” The U.S. Patent and Trademark Office (USPTO) would typically allow a general purpose computer to satisfy the “particular machine” requirement of the “machine-or-transformation” test (“MorT test”). In addition, when a method could be expressed as steps conducted by a software program on a disc, patent attorneys could get around the machine-or-

transformation test by structuring the claim in that fashion (the argument being that a disc is a machine, so one could claim a disc a/k/a “computer-readable medium” with novel code on it).

Prior Law at the Trial Courts

On the other hand, if a financial services company was sued for infringing another’s so-called “business method” patent, many of the federal district courts were not so kind to these patents. Many of these district courts were not convinced of the legal fiction that a general purpose computer becomes a “particular machine” when a novel program is performed by it. Going further, some courts looked beyond the form of the claim and used the MorT test to invalidate machine claims that were written as, for example, general purpose computers that performed novel processes or novel processes stored in a computer-readable medium, such as a disc drive or memory. (For further discussion, see Blake Reese, [Judicially Re\(De\)Financing Software Patent Eligibility: A Survey of Post-Bilski Jurisprudence](#) (April 6, 2010).) Nonetheless, other district courts followed the status quo that as long as a method claim had some computer hardware in the claims, or if the claim was written as a machine

claim that it was eligible for a patent. Of course, just because an invention is eligible subject matter for a patent does not mean that a patent should issue. The claim still has many other hurdles to overcome, like whether it is new and nonobvious. Meanwhile, the Federal Circuit Court of Appeals had about a half-dozen or so of these district court cases on appeal and the major players in all industries were waiting to see how the Federal Circuit would clarify the MorT test. In other words, which district courts would it say were getting “it” right.

The Supreme Court’s Important Statements

In *Bilski v. Kappos*, the Supreme Court held that the MorT test is merely a “useful and important clue,” but is “not the sole test for deciding whether” a claimed process is patent eligible. Instead, the court focused on its own prior precedent and concluded that the claims-at-issue were within what had been previously characterized as an unpatentable abstract idea. In its opinion, the court did not define what would constitute a patentable “process.” As a result, the Supreme Court deferred to the Federal Circuit to develop “other limiting criteria” for assessing whether claimed processes, including certain business methods, may be patented.

Bilski v. Kappos Implemented at the USPTO

From a practical standpoint, the USPTO will now look at a financial services company’s patent application in virtually the same way as it did before the Supreme Court issued its opinion. Last week, as previously stated, the USPTO exclusively

applied the MorT test to process claims. Under the USPTO’s Interim Guidelines that were released on June 28 after the Supreme Court’s decision, the USPTO stated that it will still apply the MorT test. If a patent applicant’s claims fail that test, the applicant now has an additional argument that, despite its failing to satisfy the MorT test, the claims are not “abstract.” Abstraction law is confusing and archaic; it is not a child of the information age. The appellate board at the USPTO (a/k/a the Board of Patent Appeals and Interferences) will almost certainly come out with its own new tests for determining what is “abstract” which will be, in theory, based on these older abstraction cases and subject to tweaks and rewrites by the Federal Circuit’s own development of abstraction law. Importantly, the USPTO, at least, is limiting *Bilski v. Kappos* to process claims, so machine claims are largely unaffected – a strategy of which financial services companies and the entities that go after them will be aware.

No Mention About the Elephant in the Room

Practitioners and industry stakeholders still do not have a definitive answer as to whether a general purpose computer can be a “particular machine” under the MorT test. As a result, financial services companies will continue to file so-called “business method” applications and absent any significant changes, those applications will issue as patents despite their relying solely on a general purpose computer as the claims’ “particular machine” or being written as a general purpose computer, computer readable-medium or the like.

Watching the Next Two Quarters

In the next several months, the Federal Circuit will be deciding cases that will likely give teeth to the principles in the Supreme Court’s decision. These Federal Circuit opinions and the interpretations of them by the USPTO will likely have more of an impact on these companies’ applications. In the interim, expect plaintiffs to assert those patents that were collecting dust because they lacked sufficient hardware to be considered a “machine” or tied to a “particular machine.” Also, expect defendants to claim the software or business method patents that are asserted against them are invalid for being “abstract.”

In short, unfortunately, more wait-and-see in industries that often lack the virtue of patience.

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– *Chambers USA 2010*

Learning from the Goldman Sachs Trade Secret Case

By
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Companies must be careful when using open source code in their proprietary systems.

As a computer science student in the '80s, I was well-steeped in the pioneering spirit that led to the modern open source code movement. Back then, we were far too busy exploring the potential of digital computers (remember artificial intelligence?) to concern ourselves with notions of ownership or commercialization. Those who were lucky enough to break new ground were happy to share their accomplishments with the programming community in the hopes of earning some modest peer recognition while helping others take the next step.

When computer programs became widely integrated into commercial society in the '90s, the free software movement began looking for ways to formalize the traditional openness among programmers. This formalization took the form of open source code licenses. These licenses allowed programmers to

freely use “open source” software code in commercial products if they agreed to certain open source terms. Unfortunately, there was little uniformity between open source licenses, and “acceptable” open source terms ranged from the innocuous (using proper copyright notice) to the egregious (agreeing to license any of your own programs that contain open source code for free). While sophisticated companies certainly recognized the cost benefit of using “off the shelf” software, the attendant legal complexities have not always been routinely considered.

The recent Goldman Sachs trade secret trial provides yet another reason to carefully consider the use of open source software. In early December, Sergey Aleynikov was convicted of stealing trade secret computer code he developed for his former employer, Goldman Sachs. According to court documents, the government alleged that Aleynikov took the software code to enable him to develop a competing program for his new employer, Teza Technology.

In developing proprietary code for Goldman, however, Aleynikov apparently incorporated some open source elements. In defending against the



misappropriation charges, Aleynikov’s lawyers argued that he did not intend to take Goldman trade secret code, but, rather, he was merely trying to take the open source code he was entitled to take under the applicable open source license. This defense added a second level of complexity to what ordinarily would have been an open-and-shut case. Not only would a jury need to decide that Aleynikov took software with him, they would also need to determine that the purloined software was open source. Given the vagaries of many open source licenses, this second question is not always easy to answer.

While it appears that the government was able to overcome the “open source” defense in the Goldman case, other companies may not be so lucky. To prevent “open source” issues from overriding proprietary protection, companies need to carefully consider the use of open source code in their proprietary systems.

If open source code is used, technical directors need to ensure that it is physically and logically segregated from proprietary source code elements. In-house counsel should also be aware of the origin of any open source elements being used so that

they can evaluate the applicable open source license terms. Finally, companies should not let programmers make the decision on whether or not to include open source code in proprietary systems. The legal and business implications of open source are far too nuanced to allow decisions to be made real-time during software development.

What Can Decisions by European Courts Teach Us About the Future of Open-Source Litigation in the United States?

By
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Presented at the 2010 AIPLA
Spring Meeting in New York City.



Introduction

Corporations can no longer ignore the commercial impact and cultural changes resulting from the exponentially increasing adoption of and reliance on open-source software. Unlike traditional proprietary software licenses that afford access only to machine-readable object code and generally for a fee, open-source software is available to the public at no charge. The licensee receives the human-readable source code, which it may modify for use in any field of endeavor, and redistribute both the original code and its derivative works to others.² Powerful non-profit, volunteer communities, such as the Free Software Foundation (“FSF”), Apache Software Foundation, and Eclipse Foundation, bring together the talents of thousands of skilled developers who engage in collaborative development and enhancement of open-source software.³ Companies with sizeable IT departments bring the software in-house and use it to create new proprietary offerings or develop

custom features and functionalities to meet their unique internal business requirements. The availability of open-source software and the extensive collaboration that fosters its enhancement are widely believed to allow the development, modification, and debugging of software through processes that are faster and less expensive than if the creator were required to do all of the work independently.

The United States Court of Appeals for the Federal Circuit recognized this phenomenon in the landmark case *Jacobsen v. Katzer*, observing that “[o]pen source licensing has become a widely used method of creative collaboration that serves to advance the arts and sciences in a manner and at a pace that few could have imagined just a few decades ago.”⁴ Unsurprisingly, the widespread use of open-source software has created a groundswell in the number of actions filed by licensors who believe that their intellectual property and contractual rights have been infringed. These licensors turn to federal courts when informal enforcement

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² Open Source Initiative, “Open Source Definition.” <http://www.opensource.org/docs/osd> (accessed April 2, 2010).

³ The Free Software Foundation identifies itself as a proponent of “free” rather than “open” software, viewing open source as a “development methodology” and free software as a “social movement.” Richard Stallman, “Why Open Source misses the point of Free Software,” <http://www.gnu.org/philosophy/open-source-misses-the-point.html> (2007). For purposes of this article, we use the term “open source” to refer to software available under the Open Source Definition and do not distinguish licenses that the FSF may consider to be “non-free.”

⁴ *Jacobsen v. Katzer*, 535 F.3d 1373, 1378 (Fed. Cir. 2008).



requests fail to bring users of the source code into compliance. Those suits are often brought by, or in close cooperation with, open-source or free software communities and their legal counterparts.

But years earlier, European courts began laying the foundation for the enforcement of open-source licenses taking place today in the United States. And the same volunteer, non-profit organizations that now lead compliance efforts and drive the litigation in this country also filed or offered material assistance in the early European court cases. This paper traces some of the roots of current strategies in the United States for enforcement of open-source licenses back to the ground-breaking decisions in Europe. We also highlight the impact of those decisions abroad on recent and ongoing federal litigation.

Corporate America Meets Open-Source

The requirements and restrictions of open-source licenses vary dramatically. The many variations of the permissive Berkeley Software Distribution (“BSD”) License allow the licensee to distribute and modify the subject code essentially without limitation, provided that the text of the license (including the disclaimer of warranties) and applicable copyright notices are provided with the distribution.⁵ The popular Apache Software License v.2.0 similarly enables the end-user to distribute its derivative works of the code under the licensing terms of its choice.⁶ Unless a “patent retaliation” clause is triggered by a licensee’s suit alleging that the software infringes its patent rights, the licensee enjoys the benefits of broad, explicit patent and copyright licenses that mirror those

granted by the original creators of the software under Contributor License Agreements. The BSD and Apache licenses have found great favor with the private sector because they permit the licensees to exploit the software commercially as long as they abide by reasonable documentation requirements.

By contrast, the philosophy of other open-source licenses is “copyleft”⁷ – that is, in exchange and consideration for use of the subject work, the copyright holder allows licensees to copy, modify, and distribute the code and their derivative works thereto *provided that* downstream users are afforded the same privileges of accessibility and use of the licensee’s derivative works. A pure copyleft license provides each user or holder of a software program the same “four essential freedoms” as the software’s creator:

⁵ See, e.g., Open Source Initiative, “Open Source Initiative OSI - The BSD License: Licensing,” <http://www.opensource.org/licenses/bsd-license.html> (accessed April 2, 2010).

⁶ Apache Software Foundation, “Apache License Version 2.0, January 2004,” <http://www.apache.org/licenses>; <http://www.apache.org/licenses/LICENSE-2.0.txt> (2004). See also Opscode, Inc., “Why We Chose the Apache License,” <http://www.opscode.com/blog/2009/08/11/why-we-chose-the-apache-license/> (August 11, 2009), for an interesting layman’s perspective on the benefits of using the Apache Software License v.2.0 as an outbound licensing mechanism.

⁷ See generally Free Software Foundation, Inc., “What is Copyleft?,” <http://www.gnu.org/copyleft/> (accessed April 2, 2010).

0. the freedom to run the program, for any purpose,
1. the freedom to study how the program works (through access to the source code) and change it at will,
2. the freedom to copy and share the program with others, and
3. the freedom to share modifications with others.⁸

The GNU General Public License (“GPL”) is the most well-known copyleft license. By way of example, copyleft licenses may contain:

- a requirement that the licensee publish or make available the source code for any works based on or derived from the original software;
- a requirement that the licensee send the sponsoring open-source community a copy of all versions of derivative software created using the software; or
- a requirement that software documentation be made available at no charge.

“Weak” copyleft licenses permit the licensee to include or link to the original, unmodified code in a greater work without being required to license the entirety of the new work under the open-source license. Examples of weak copyleft licenses are the Mozilla Public License and the Eclipse Public License. While the GNU Lesser General Public License (“LGPL”) is sometimes referred to as a weak copyleft license, its narrow safe harbor and diverse interpretations of how to link safely to LGPL-licensed code warrant a much more rigorous analysis than

...the widespread use of open-source software has created a groundswell in the number of actions filed by licensors who believe that their intellectual property and contractual rights have been infringed.

the more straightforward Mozilla and Eclipse requirements.

The free software philosophy first captured the attention of corporate America in 1994 when Linus Torvalds released Linux, a free, Unix-type operating system, under the GPL.⁹ Corporate counsel and their clients were uncertain how to comply with the terms of this new licensing structure and what the risks were of noncompliance. United States common law on open-source licensing issues was undeveloped, and practitioners struggled in applying the artistically focused Copyright Act to the technicalities of software.¹⁰

Many lawyers relied on online, informal guidance published by open-source communities, which consisted primarily of developers and other non-lawyers. But the relatively low level of enforcement activity actually conducted by these communities added uncertainty as to how real and costly the risks were for failing to comply with the terms of an open-source license. The number of devices and companies that relied upon or included open-source software continued to expand rapidly.

There is no longer a question that the risks and ramifications of noncompliance are real. By the end of 2007, the FSF, with the assistance of the Software Freedom Law Center, had filed copyright infringement actions in the United States District Court for the Southern District of New York (“SDNY”) against Verizon Communications, Xterasys, and High-Gain Antennas based on the defendants’ distribution of open-source, Unix-based Busy Box software in alleged violation of the GPL. The FSF withdrew the complaint in each of those actions shortly after filing suit, but only after each defendant agreed to comply with the terms of that license. (These suits and others are described in more detail below.)

European case law allowing licensors to strictly enforce the GPL against wayward licensees, coupled with other publicized settlements of open-source disputes in the European Union, was undoubtedly a significant factor in the 2007 SDNY cases. These unwavering, bright-line decisions empowered the free software proponents while serving as a cautionary tale to the corporate defendants. Pioneering judges from across the pond have created a *de facto* precedent for American courts in information technology law and policy – a compelling reminder to remain aware of global trends in intellectual property law. Today, both formal and informal enforcement activity of open-source licenses continues to intensify, and many more related copyright infringement and breach of contract cases have been filed in federal district courts as of the date of this article.

⁸ Free Software Foundation, Inc., “Free Software Definition,” <http://www.gnu.org/philosophy/free-sw.html> (accessed April 2, 2010). While the four freedoms are paraphrased above, we have retained Richard Stallman’s unique numbering scheme that begins with a zero rather than a one.

⁹ Linux Online Inc., “What is Linux,” <http://www.linux.org/info/> (July 2, 2007).

¹⁰ 17 U.S.C. §§ 101 et seq.

It All Started With A 25-Year-Old German Developer...

In 2003, Harald Welte, a young programmer from Berlin, was a principal contributor to and copyright owner of netfilter/iptables, a packet filtering framework for the Linux kernel that is licensed under the GNU General Public License.¹¹ Welte became frustrated over what he perceived as a pervasive, industry-wide failure of wireless networking manufacturers who embedded netfilter code in their products to comply with the terms of the GPL. After being named chairman of the netfilter core team that managed the open-source project, Welte began active enforcement activity targeted at the manufacturers. He founded the gpl-violations.org project in January 2004 to advocate and investigate compliance with the GPL, then proceeded to obtain several out-of-court settlement agreements in which the licensees agreed to remedy their licensing violations.¹² Welte sent one such cease and desist notice to Sitecom Germany GmbH, the German subsidiary of a Dutch wireless networking company.¹³ After Sitecom declined to cooperate, Welte filed an action for copyright infringement in the Munich district court alleging that Sitecom violated the terms of the GPL by (i) failing to make available the source code for its wireless access router and (ii) failing to distribute a copy of the GPL license to its end-users. He sought a preliminary injunction to stop

Today, both formal and informal enforcement activity of open source licenses continues to intensify, and many more related copyright infringement and breach of contract cases have been filed in federal district courts as of the date of this article.

distribution of the product pending compliance by Sitecom with the open-source license.

On April 2, 2004, a three-judge panel issued the injunction and upheld it on May 19, 2004, in response to Sitecom's objection.¹⁴ The German court held that the terms of the GPL were enforceable and that Sitecom had no right to distribute netfilter/iptables-based products without complying with the GPL's conditions. The milestone decision was reported worldwide, both within and beyond the open-source community. Till Jaeger, counsel for Welte and co-founder of the Institute for Legal Issues of Free and Open-Source Software, noted: "To my knowledge, this is the first case in which a judicial decision has been decreed on the

applicability and the validity of the GNU GPL."¹⁵

Formal enforcement of open source licenses thus began with the targeting of primarily router and network appliance manufacturers, likely due in part to the discrete architecture of the technology and the relative ease of demonstrating noncompliance. Because the software for these devices is necessarily integrated and embedded in the hardware as "firmware," manufacturers encountered difficulty claiming that they were not distributing or conveying a work "based on" the GPL-licensed code.¹⁶ There may also have been insufficient policing of internal software development and licensing practices by the hardware manufacturers because it was not viewed as a critical business issue at the time.

Emboldened by their success and indeed, an apparent batting record of a thousand, Welte and the gpl-violations.org project broadened the scope of their efforts to include an infringing operating system. Fortinet UK Ltd. ("Fortinet") sold a line of security appliances that were marketing as running on the proprietary "FortiOS" operating system. The GPL watchdogs analyzed the operating system and determined that it contained portions of the Linux kernel that were not being distributed in compliance with the GPL.¹⁷ Moreover, the project concluded that Fortinet had knowingly concealed its use of the Linux code through the use of cryptographic tools.¹⁸

¹¹ <http://netfilter.org/about.html#license> (accessed on April 3, 2010).

¹² <http://www.gpl-violations.org/about.html#history> (accessed on April 3, 2010).

¹³ Harald Welte, "Preliminary Injunction to enforce netfilter/iptables GPL," <http://lists.netfilter.org/pipermail/netfilter-announce/2004/000057.html> (April 15, 2004).

¹⁴ For a report of this decision, see http://news.cnet.com/2100-7344_3-5198117.html (April 22, 2004); see also <http://www.gpl-violations.org/news/20040415-iptables.html> (April 15, 2004). The decision itself is located at http://www.ifross.org/ifross_html/eVWelte.pdf (accessed April 3, 2010). An unofficial English-language translation by Thorsten Feldmann, LL.M., Esq., and RRef. Julian Hoeppner, LL.M., Jaschinski Biere Brexli Rechtsanwälte, Berlin is available at http://www.jbb.de/fileadmin/download/judgment_dc_munich_gpl.pdf.

¹⁵ Harald Welte, "Preliminary Injunction to enforce netfilter/iptables GPL," <http://lists.netfilter.org/pipermail/netfilter-announce/2004/000057.html> (April 15, 2004).

¹⁶ The GNU General Public License Version 2 focuses on whether the licensee is "distributing" a covered work, while the GNU General Public License Version 3 published in June 2007 queries whether a covered work has been "conveyed." See generally Free Software Foundation, Inc., "Licenses," <http://www.gnu.org/licenses/licenses.html> (accessed April 3, 2010). The difference in application of these terms is beyond the scope of this article.

¹⁷ <http://gpl-violations.org/news/20050414-fortinet-injunction.htm> (April 14, 2005).

¹⁸ *Id.*

Fortinet, however, did not yet take the project's efforts to engage it seriously, and it refused to either honor the cease-and-desist notice or otherwise settle the project's claims of infringement. Again, Welte sought reinforcement from the Munich district court.

On April 14, 2005, the court granted a preliminary injunction against Fortinet, agreeing with Welte's assertions that Fortinet did not have the right to continue distributing the Linux kernel in its operating system without abiding by the terms of the GPL.¹⁹ In order to return to the marketplace, Fortinet was required to modify its end user license agreement to conform to the GPL, and make available the corresponding source code for the covered code.²⁰

Welte's gpl-violations.org project prevailed again in litigation in 2006, this time against D-Link Germany GmbH ("D-Link"), a German subsidiary of the Taiwanese manufacturer and a distributor of its hardware and network devices.²¹ D-Link had distributed a Wireless G network attached storage (NAS) device that contained at least three software components from the Linux kernel, all of which were licensed under the GPL.²² D-Link, however, did not provide either a copy of the GPL or the requisite disclaimer of warranties to its customers, and it did not disclose the source code for the data storage unit to the public. Although D-Link agreed to address these breaches, it refused to reimburse Welte for the costs of

investigation, a remedy potentially available to him under the German Civil Code.²³

Welte brought suit in the Frankfurt district court, alleging copyright claims based on the GPL and claiming that he was entitled to reimbursement for the expenses of the enforcement activity. In the proceedings, D-Link argued that the GPL was not legally binding, "[r]egardless of the repeatedly-quoted judgement of the district court of Munich...", a reference to the Sitecom decision discussed herein.²⁴ D-Link contended that the GPL's requirement that source code be made available at no charge was in essence a price-fixing obligation, and hence unenforceable as a violation of antitrust law.²⁵ D-Link also contended that it could not be

¹⁹ *Id.*; see also Pinsent Masons, LLP, "Software firm settles GPL violation lawsuit," <http://www.out-law.com/page-5620> (April 28, 2005); CBS Interactive, "Fortinet Accused of GPL Violation," <http://www.zdnet.co.uk/news/application-development/2005/04/14/fortinet-accused-of-gpl-violation-39195174/> (April 14, 2005).

²⁰ http://news.cnet.com/Fortinet-settles-GPL-violation-suit/2100-7344_3-5684880.html (accessed April 5, 2010).

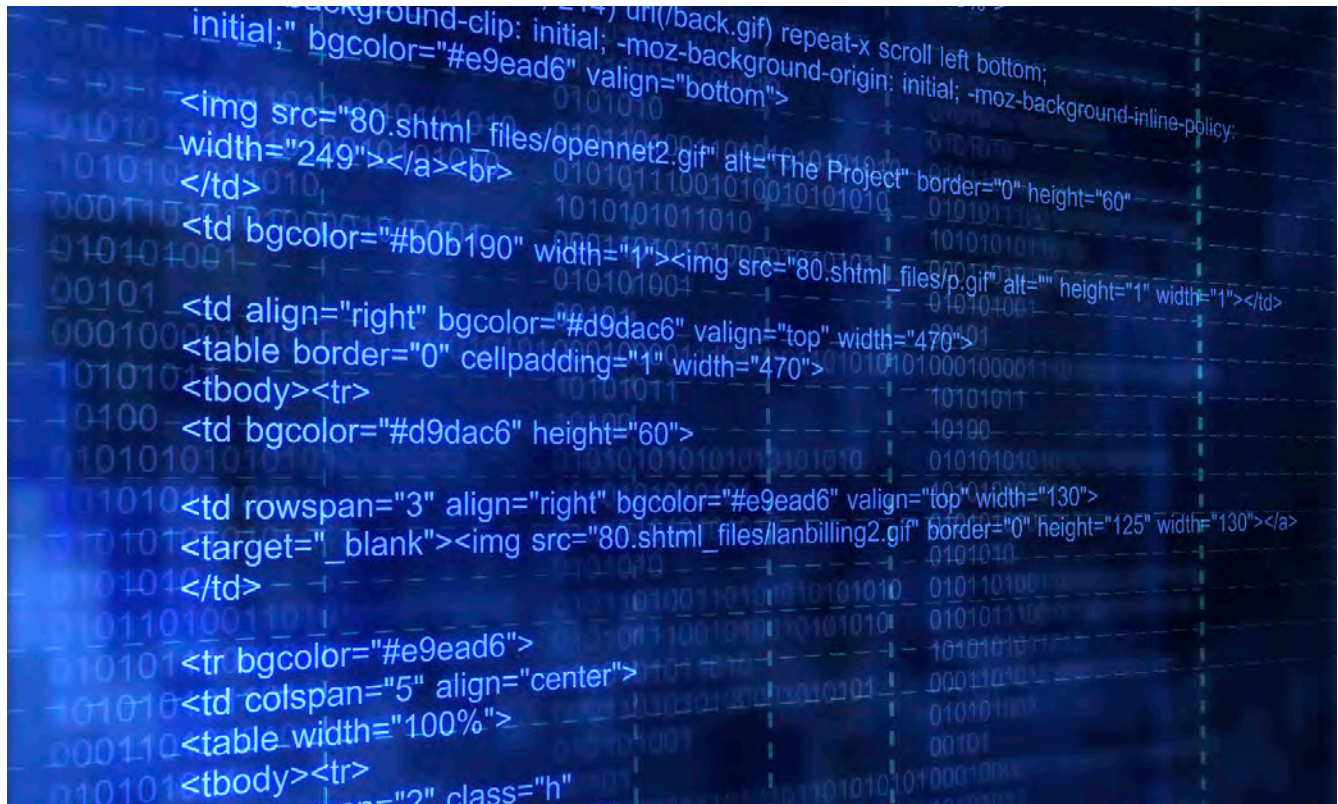
²¹ http://www.gpl-violations.org/news/20060922-dlink-judgement_frankfurt.html (accessed on April 3, 2010).

²² The authors of the software had granted Welte exclusive rights in the code, thus enabling Welte to license the software to others under the GPL and granting him standing to enforce the terms of the license in the German court. http://thinkingopen.files.wordpress.com/2007/07/d-link-verdict-english-translation-061028_2_.pdf (accessed on April 4, 2010).

²³ See Sections 670 and 683 of the German Civil Code. An English translation of the German Civil Code is provided by the German Federal Ministry of Justice at http://www.gesetze-im-internet.de/englisch_bgb/index.html.

²⁴ http://www.gpl-violations.org/news/20060922-dlink-judgement_frankfurt.html (accessed on April 3, 2010).

²⁵ http://thinkingopen.files.wordpress.com/2007/07/d-link-verdict-english-translation-061028_2_.pdf (accessed on April 4, 2010).



held liable for infringement because its status as a subsidiary meant that it was merely a distributor of the data storage unit and had no knowledge of the code actually embedded in the device.

On September 6, 2006, the district court issued its judgment, confirming Welte's claims of copyright infringement and specifically holding that the GNU GPL was valid and enforceable under German law.²⁶ The court rejected D-Link's claim that it was not responsible for infringement because it was merely a distributor. In a statement foreshadowing the Federal Circuit's 2008 decision in *Jacobsen* (discussed below), the court noted in response to D-Link's antitrust defense that if a would-be licensee refused to accept the licensing terms imposed by the copyright owner of software, regardless of the rationale for refusal, then it could not somehow claim the right to distribute the software under the terms of its choice.²⁷ The court also ordered D-Link to reimburse Welte for most of his requested expenses for legal services, testing, and re-engineering.

After the victory, Welte issued a statement condemning D-Link's attitude and hinting at the implementation of more aggressive enforcement tactics:

"It was very sad to see D-Link starting to argue that the GPL would not apply. Given D-Link's repeated license violations, it can be thankful that we've never asked for any kind of damages, but merely to cease and desist from further infringements, plus our expenses. I start to wonder

whether they actually deserve such a mild strategy."²⁸

Another clear-cut win for the free software proponents; the court's resounding validation of the GPL's legitimacy plainly advanced both their cause and their zeal.

Thus, it was a trio of decisions by German courts that led the way in recognizing and enforcing free and open-source software licenses. Welte crowed on the [gpl-violations.org](http://www.gpl-violations.org) site: "By June 2006, the project has hit the magic '100 cases finished' mark, at an exciting equal [sic] '100% legal success' mark. Every GPL infringement that we started

Many contracts between software licensors and their customers contain warranties of noninfringement and other terms that enable the customers to claim monetary damages for the licensor's unauthorized distribution of third-party intellectual property, if not specific performance obligating the licensor to remediate the infringement.

to enforce was resolved in a legal success, either in-court or out of court."²⁹ The project announced that numerous "major companies" had agreed to out-of-court settlements of GPL enforcement activity, including Siemens, Fujitsu-Siemens, Asus, Belkin, and TomTom B.V.³⁰ The Free Software Foundation presented Welte with the 2007 FSF Award for the Advancement of Free Software as recognition for his leadership in licensing enforcement; he subsequently received the 2008 Google-Reilly Open-Source Award for Defender of Rights. He continues to lead [gpl-violations.org](http://www.gpl-violations.org) vigorously as of the date of this article.

A French Appellate Court Enforces the GPL in Favor of a Software Recipient

While Welte and [gpl-violations.org](http://www.gpl-violations.org) energetically enforced the GPL in German courts, the Free Software Foundation France ("FSF France") was helping a downstream licensee pursue its rights under an open-source license in a case of first impression under the French Civil Code. The licensee, *Association pour la formation professionnelle des adultes* ("AFPA"), maintained training facilities that included tele-mentoring and other adult educational programs.³¹ EDU 4, a manufacturer of multimedia teaching rooms, was the successful bidder to a request for proposals issued by AFPA and provided AFPA with certain equipment and software that included a modified version of Virtual Network Computing ("VNC") software. VNC software enables a desktop user to view and control another desktop connected to the Internet. The version of VNC

²⁶ *Id.*

²⁷ *Id.* See also Groklaw, "GPL Upheld in Germany Against D-Link," <http://www.groklaw.net/articlebasic.php?story=20060922134536257> (September 22, 2006).

²⁸ http://www.gpl-violations.org/news/20060922-dlink-judgement_frankfurt.html (accessed on April 3, 2010).

²⁹ <http://www.gpl-violations.org/about.html#history> (accessed on April 3, 2010).

³⁰ <http://www.gpl-violations.org/news/20041004-majorupdate.html>; <http://www.gpl-violations.org/news/20041024-linux-tomtom.html> (accessed on April 3, 2010).

³¹ A copy of the decision is available at <http://fsffrance.org/news/arret-ca-paris-16.09.2009.pdf>. The authors of this article relied upon an unofficial English translation of the decision for their discussion of the case. If possible, that translation will be made available at http://www.milbank.com/en/Attorneys/g-i/Gaspar_Christopher.htm.

provided by EDU 4 was subject to the GNU GPL.

EDU 4 did not acknowledge the presence of the VNC software in the media that it provided.³² In its distribution, it also had deleted the VNC license, copyright notices, and attributions originally contained in the software and inserted its own. FSF France, another open-source community advocate for enforcement of the GPL, assisted AFPA by identifying the specific violations of the GPL and attempting to mediate a resolution with EDU 4, but to no avail.³³ In early 2002, AFPA unilaterally terminated the contract with EDU 4, due in part to the perceived violation of the GPL and its claim that EDU 4 had concealed the true pedigree of this code.³⁴ EDU 4 sued AFPA for breach of contract and was awarded damages by the Trial Court of Bobigny on September 21, 2004.

On appeal, AFPA alleged that it was entitled to rescission under Article 1184 of the French Civil Code.³⁵ AFPA also sought restitution of amounts it had paid under the contract. The Court of Appeals of Paris agreed and overturned the lower court's ruling on September 16, 2009.³⁶ The court determined that EDU 4 breached its contractual obligations by, *inter alia*, delivering software that did not satisfy the notice and attribution requirements of the GPL. Because EDU 4 did not provide AFPA with the source code for its modifications to the VNC software despite repeated requests from both AFPA and FSF France, the



court also determined that EDU 4 could not assert that it had made a compliant delivery of software.³⁷ This was the first time that the French courts treated the GPL as enforceable and binding.³⁸

Two additional aspects of this decision bear mention here. First, the decision established that, under French civil law, an end-user of software licensed under the GPL can seek judicial relief regarding compliance with its terms, based on rights granted to that downstream licensee by the copyright owner.³⁹ While this ruling does not automatically bestow standing on an unlimited class of potential enforcers in United States courts, it serves as a reminder that the FSF is not the only party that can enforce the General Public License.⁴⁰ Further, many contracts between software licensors and their customers contain warranties of noninfringement and other terms that enable the customers to claim monetary damages for the licensor's

unauthorized distribution of third-party intellectual property, if not specific performance obligating the licensor to remediate the infringement. The existence of these commercial terms can have the same practical impact in federal court as the AFPA's claim for rescission under French civil law.

Second, the appeals court's ruling concerned software preloaded on a personal computer, unlike the German cases governing firmware on routers, appliances, and other hardware. The investigative focus of free and open-source software advocates has clearly broadened to include non-embedded software that can readily be distributed independently of hardware. This reinforces the need to comprehend how expansively the open-source proponents may scrutinize applications, middleware, and utilities to assess their incorporation of open-source code and the parameters they will apply to determine whether the

³² *Id.*

³³ FSF France, "Paris Court of Appeals condemns Edu4 for violating the GNU General Public License," <http://fsffrance.org/news/article2009-09-22.en.html> (September 22, 2009).

³⁴ <http://fsffrance.org/news/arret-ca-paris-16.09.2009.pdf> (September 16, 2009).

³⁵ *Id.* A copy of Article 1184 is available at <http://www.legifrance.gouv.fr/affichCodeArticle.do?cidTexte=LEGITEXT000006070721&idArticle=LEGIARTI000006436635&dateTexte=20100404> (February 1804).

³⁶ *Id.*

³⁷ *Id.*; <http://fsffrance.org/news/article2009-09-22.en.html> (September 22, 2009).

³⁸ See Mark Radcliffe, "French Court Indirectly Finds the GPL Enforceable for the First Time," <http://lawandlifesiliconvalley.com/blog/?p=285> (September 30, 2009).

³⁹ FSF France, "Paris Court of Appeals condemns Edu4 for violating the GNU General Public License," <http://fsffrance.org/news/article2009-09-22.en.html> (September 22, 2009).

⁴⁰ SCO notoriously argued to the contrary in its Answer to IBM's Amended Counterclaims in *The SCO Group, Inc. v. International Business Machines Corp.*, No. 03-CV-294 (D. Utah) (October 24, 2003), contending that IBM lacked standing to enforce the GPL because it had failed to join the FSF as a necessary party to its claim. SCO subsequently dropped this defense in its Answer to IBM's Second Amended Counterclaims, filed on April 23, 2004.



software is a derivative work of code originally licensed under a free or open source software license.

Coming to America

The American free software movement continued to gather steam, invigorated by the achievements of their European counterparts. In 2005, Eben Moglen, professor at Columbia University Law School and longtime legal advisor to the Free Software Foundation, founded the Software Freedom Law Center (“SFLC”), a nonprofit organization dedicated to providing legal representation for advocates of free and open-source software.⁴¹ On September 19, 2007, the SFLC

and two developers of the popular BusyBox UNIX utilities sued Monsoon Multimedia (“Monsoon”) in the SDNY, in the first federal action for copyright infringement based on an alleged violation of the GPL.⁴² The plaintiffs sought actual damages, attorney fees, and injunctive relief.⁴³

BusyBox, the “Swiss Army Knife of Embedded Linux,” is a single executable program comprised of numerous, bare-bone UNIX utilities for devices such as cell phones and PDAs.⁴⁴ BusyBox is distributed under the terms of the GPL Version 2, which requires that re-distributors of a GPL-licensed program give recipients access to the corresponding source code.⁴⁵

The plaintiffs alleged that Monsoon improperly failed to make available the source code for the firmware embedded on its media devices, though Monsoon had acknowledged on its online support forum that its firmware included BusyBox code and it was otherwise providing the firmware for download in object form.⁴⁶ They also claimed that the only permission Monsoon had to distribute BusyBox software was pursuant to the GPL, characterizing that permission as “contingent” on Monsoon’s compliance with its terms.⁴⁷

The parties settled the case on October 30, 2007, just six weeks after the complaint was filed.⁴⁸

⁴¹ <http://www.softwarefreedom.org/> (accessed on April 4, 2010).

⁴² *Andersen v. Monsoon Multimedia, Inc.*, No. 07-CV-8205 (S.D.N.Y. 2007); see Software Freedom Law Center, “On Behalf of BusyBox Developers, SFLC Files First Ever U.S. GPL Violation Lawsuit,” <http://www.softwarefreedom.org/news/2007/sep/20/busybox/> (September 20, 2007).

⁴³ It is not clear from the *Monsoon* filings why the developers did not seek statutory damages under the Copyright Act, but it is possible that they had not yet satisfied the registration requirements for that remedy. 17 U.S.C. §§ 412, 504(c).

⁴⁴ *Monsoon* Complaint ¶ 6; <http://www.busybox.net/about.html> (accessed on April 5, 2010).

⁴⁵ As noted in the Preamble to the GPL: “[I]f you distribute copies of such a program, whether gratis or for a fee, you must give [pass on to] the recipients all the rights that you have [the same freedoms that you received]. You must make sure that they, too, receive or can get the source code. And you must show them these terms so they know their rights.” <http://www.gnu.org/licenses/gpl-2.0.txt>; <http://www.gnu.org/licenses/gpl-3.0.txt> (variations shown in brackets).

⁴⁶ *Monsoon* Complaint ¶¶ 11, 15.

⁴⁷ *Id.* at ¶ 12.

⁴⁸ Software Freedom Law Center, “BusyBox Developers and Monsoon Multimedia Agree to Dismiss GPL Lawsuit,” <http://www.softwarefreedom.org/news/2007/oct/30/busybox-monsoon-settlement/> (October 30, 2007).

In addition to the payment of an undisclosed sum, Monsoon agreed to appoint an open-source compliance officer, publish the source code for the BusyBox software it had distributed, and notify previous recipients of the software of their rights under the GPL.⁴⁹ The victory inspired the plaintiffs and their counsel to file a rapid stream of separate, near-identical copyright infringement claims in the SDNY against Verizon Communications, High-Gain Antennas, L.L.C., and Xterasys Corporation.⁵⁰ Like Monsoon, each defendant quickly agreed to comply with the GPL by publishing the source code for the firmware, and the cases were settled under terms substantially similar to those in the Monsoon litigation.

On December 11, 2008, the FSF, represented by the SFLC, brought a suit in the SDNY for copyright infringement against Cisco Systems, Inc.⁵¹ The Cisco case was the first U.S.-based enforcement action filed by the FSF and the first case prosecuted by the SFLC involving open-source software other than BusyBox.⁵² The FSF alleged that Cisco infringed the FSF's copyrights in various GNU tools licensed under either the GPL or the GNU Lesser General Public License ("LGPL") when the company distributed Linksys routers and other products embedding the GNU software, but failed to give its users access to corresponding source code as required by those licenses.⁵³ The

complaint also set forth a stance considerably more aggressive than that of the earlier BusyBox litigation, explicitly invoking the automatic termination clause of the GPL and LGPL and contending that Cisco had lost all rights to redistribute the GNU software or any modifications thereto "the instant that [it] made

While the list of conquests by the FSF and SFLC is impressive and there is no reason to expect that the trend of filings will ebb, the litigation is not without controversy in the open-source community.

noncompliant distribution of the Program in its Infringing Products or Firmware."⁵⁴

The hard-line tactics were due in large part to the evidently unproductive exchanges regarding the alleged violations that had taken place between the FSF and Linksys for several years before the FSF commenced the lawsuit.⁵⁵ In a statement announcing the filing of the lawsuit, the FSF explained its disappointment with the earlier

compliance efforts:

"We began working with Cisco in 2003 to help them establish a process for complying with our software licenses, and the initial changes were very promising," explained Brett Smith, licensing compliance engineer at the FSF. "Unfortunately, they never put in the effort that was necessary to finish the process, and now five years later we have still not seen a plan for compliance. As a result, we believe that legal action is the best way to restore the rights we grant to all users of our software."⁵⁶

Queries about Linksys' compliance with the GPL had been rampant on developer blogs and forums when Cisco acquired the privately held company for \$500 million in June 2003; the larger corporation apparently failed to "meaningfully improve" upon those licensing practices when the FSF continued its discussions with the new parent company.⁵⁷

Shortly thereafter, and before Cisco was required to formally respond to the FSF's complaint, the FSF announced that the parties had settled the dispute.⁵⁸ Cisco and the FSF jointly announced the terms of the settlement, which included Cisco's agreement to: (1) appoint a Free Software Director for Linksys to supervise the subsidiary's compliance with the requirements of free software licenses; (2) report

⁴⁹ *Id.*; see http://news.cnet.com/8301-13580_3-9808378-39.html (describing the case as "signal[ing] a new assertiveness on the part of open-source programmers").

⁵⁰ Complaints were filed against High-Gain Antennas, L.L.C. and Xterasys Corporation on November 19, 2007, and against Verizon Communications on December 6, 2007; all three cases involved the distribution of routers and gateways with BusyBox embedded in the firmware. See <http://www.linux-watch.com/news/NS8734215139.html> (December 7, 2007).

⁵¹ *Free Software Foundation, Inc. v. Cisco Sys., Inc.*, No. 08-CV-10764 (S.D.N.Y. 2008).

⁵² See Ars Technica, "Free Software Foundation lawsuit against Cisco a first," <http://arstechnica.com/open-source/news/2008/12/free-software-foundation-lawsuit-against-cisco-a-first.ars> (December 11, 2008).

⁵³ *Cisco Complaint* ¶ 26.

⁵⁴ *Id.* at ¶ 28.

⁵⁵ *Id.* at ¶¶ 29-42.

⁵⁶ *Free Software Foundation*, "Free Software Foundation Files Suit Against Cisco For GPL Violations," <http://www.fsf.org/news/2008-12-cisco-suit> (December 11, 2008).

⁵⁷ *Cisco Complaint* ¶ 42. See, e.g., Forbes.com, "Linux's Hit Men," http://www.forbes.com/2003/10/14/cz_dl_1014linksys.html (October 14, 2003); "Embedded Linux and the GPL" [including comments], <http://lwn.net/Articles/35712/> (June 10, 2003); "Linux and Linksys: The Saga Continues" [with comments], http://www.oreillynet.com/etel/blog/2003/08/linux_and_linksys_the_saga_con.html (August 12, 2003).

⁵⁸ *Free Software Foundation* "FSF Settles Suit Against Cisco," <http://www.fsf.org/news/2009-05-cisco-settlement.html> (May 20, 2009).

periodically to the FSF regarding Linksys' compliance efforts; (3) notify recipients of Linksys products of their rights under the GPL and other applicable licenses; (4) publish licensing notices online and in product documentation; (5) make source code for FSF software used with current Linksys products freely available on its website; and (6) make an unspecified monetary contribution to the FSF.⁵⁹

While the list of conquests by the FSF and SFLC is impressive and there is no reason to expect that the trend of filings will ebb, the litigation is not without controversy in the open-source community. Rob Landley – the second plaintiff in the watershed Monsoon case – disengaged from the SFLC in December 2008 and refused

to participate in any subsequent litigation.⁶⁰ Landley disliked what he called “ivory tower idealism with a negative pragmatic result,” and he did not recognize any substantive benefit to BusyBox from the SDNY settlements.⁶¹ Other developers have also begun to raise concerns about the SFLC's decision to seal the settlement agreements, a concept they perceive as counter to the objectives to an open community rather than a nod to defendants who do not wish to broadcast the amount of damages paid.⁶²

Ironically, the most recent expression of misgivings about the SFLC is from Bruce Perens, a co-founder of the Open-Source Initiative and BusyBox developer who has openly warred

with Landley for several years over the pedigree of that code.⁶³ On December 15, 2009, Perens released a statement asserting that he was the creator of the original BusyBox code base and that the SFLC did not represent his interests in the ongoing enforcement actions.⁶⁴ Perens contended:

The version 0.60.3 of BusyBox upon which Mr. Andersen claims copyright registration in the lawsuits is to a great extent my own work and that of other developers. I am not party to the registration.... Mr. Andersen, his past employers and Mr. Landley appear to have removed some of the copyright statements of other BusyBox developers, and

⁵⁹ *Id.*

⁶⁰ Rob Landley, <http://landley.net/notes-2009.html#15-12-2009>; <http://landley.net/notes-2008.html> (accessed on April 2010).

⁶¹ Linux Weekly News, “Bruce Perens: Statement on Busybox Lawsuits” [including comments], <http://lwn.net/Articles/366684/> (December 15, 2009).

⁶² *Id.*

⁶³ Bruce Perens, “Statement on BusyBox Lawsuits,” <http://perens.com/blog/d/2009/12/15/23/> (December 15, 2009); see also Linux Weekly News, “Bruce Perens: Statement on BusyBox Lawsuits” [including comments], <http://lwn.net/Articles/366684/> (December 15, 2009).

⁶⁴ *Id.*



appear to have altered license statements, in apparent violation of various laws. ... Much as other BusyBox developers wish to support the general cause of getting companies to comply with simple Free Software Licenses, some of the other developers and I are becoming annoyed with Mr. Andersen and Mr. Landley's apparent violation of our own rights, and SFLC's treatment of our interest. We have held off, to date, to avoid confusing issues, but our patience is limited.⁶⁵

He was joined on another bulletin board by longtime BusyBox maintainer Dave Cinege, who also expressed his unhappiness with the SFLC and expressly stated that he believed Andersen was subject to legal action for his own violations of the GPL:

Anderson [sic] is claiming complete Copyright [sic] and that is simply an impossibility. As far as I am concerned, this claim is a GPL violation in and of itself. ... [H]e is in violation of Section 1 GPLv2, and has lost his privileges to the software according to Section 4 GPLv2. In this case Anderson lacks standing to bring suit and he himself is open to an action.

6) One must wonder why the SFLC is working with Anderson when they have been aware that both Bruce and myself have more senior claims to the original work without the "issues" Anderson has. As Bruce

has written we've basically been snubbed by them.⁶⁶

Perens and Cinege raise interesting questions as to the validity of the copyright registrations that may have been relied upon in some of the BusyBox cases. Further, the Free Software Foundation itself has issued guidance strongly suggesting that the removal of copyright notices from GPL-licensed source code without the consent of the copyright owner would be an unauthorized modification of that code:

I want to get credit for my work. I want people to know what I wrote. Can I still get credit if I use the GPL?

You can certainly get credit for the work. Part of releasing a program under the GPL is writing a copyright notice in your own name (assuming you are the copyright holder). The GPL requires all copies to carry an appropriate copyright notice.⁶⁷

If an entity redistributing the GPL-licensed code for profit intentionally deleted copyright notices, such conduct would almost certainly generate a violation report, as in the AFPA litigation before the Paris appeals court and vigorously pursued by FSF France. Cinege's proposed application of the automatic termination clause with respect to Andersen is thus not inconsistent with policies implemented to date by the FSF and its allies. And it would be unwise to disregard Perens' subject matter expertise, which was immediately called upon by the

triumphant appellant following the Federal Circuit's landmark decision verifying the remedies available to open-source licensors.

Full Steam Ahead at the Federal Circuit

The first federal appellate decision enforcing an open-source license was issued on August 13, 2008, less than a year after the threshold *Monsoon* case was filed.⁶⁸ The United States Court of Appeals for the Federal Circuit considered "the ability of a copyright holder to dedicate certain work to free public use and yet enforce an 'open-source' copyright license to control the future distribution and modification of that work." *Jacobsen v. Katzer*, 535 F.3d 1373, 1375 (Fed. Cir. 2008). Reversing the district court, the Federal Circuit held that because the terms of the open-source license were both covenants and conditions, the copyright holder had granted a limited license that entitled it to seek remedies for both breach of contract and copyright infringement. *Id.* at 1381-82. This case is a clear indicator of a somewhat newly crystallized view of the viability of open-source licenses in the United States.

Palsgraf v. Long Island Railroad Co., 162 N.E. 99 (N.Y. 1928), set the standard for determining foreseeability in negligence cases, when a package full of unexpected fireworks fell and exploded at a railroad station. It was the model railroad enthusiasts that set the fireworks ablaze in *Jacobsen*, the new standard for the enforceability of open-source licenses. Robert Jacobsen and similarly minded developers collaborated in an open-

⁶⁵ *Id.*

⁶⁶ "Your Rights Online: Busybox Developer Responds to Andersen-SFLC Lawsuits" [including comments], <http://yro.slashdot.org/story/09/12/15/1925257/Busybox-Developer-Responds-To-Andersen-SFLC-Lawsuits> (December 15, 2009).

⁶⁷ Free Software Foundation, "Frequently Asked Questions about the GNU Licenses," <http://www.gnu.org/licenses/gpl-faq.html?sess=bf533ea338dd987ba57fe7f7c2b3b30e#1WantCredit> (accessed April 5, 2010).

⁶⁸ An earlier opinion from the United States Court of Appeals for the Seventh Circuit stated, without holding, that "[c]opyright law, usually the basis of limiting reproduction in order to collect a fee, ensures that open-source software remains free: any attempt to sell a derivative work will violate the copyright laws, even if the improver has not accepted the GPL." *Wallace v. IBM Corp.*, 467 F.3d 1104, 1105-06 (7th Cir. 2006). In that case, Wallace alleged that IBM, Red Hat, and Novell conspired to eliminate competition in the operating-system market by making Linux available at no charge and that the GPL's requirement in this regard constituted illegal price-fixing. The Seventh Circuit held that the GNU GPL did not restrain trade or violate the federal antitrust laws. *Id.* at 1107-08.

source software project called Java Model Railroad Interface (“JMRI”). JMRI created and distributed Java-based applications including the DecoderPro tool, which allows model railroad enthusiasts to program decoder chips that control the trains. At the time of the subject lawsuit, DecoderPro was available for download from the JMRI site under the terms of Artistic License.⁶⁹

Katzer developed commercial software products for the model train industry, and offered a proprietary software product, Decoder Commander, that was also used to program decoder chips. Katzer, the owner of KAMIND Associates, Inc., contended that JMRI software infringed two patents held by KAMIND and sent Jacobsen numerous letters seeking the payment of royalties.⁷⁰ Investigating, Jacobsen determined that Katzer/KAMIND had included definition files from the DecoderPro code in the Decoder Commander software in apparent noncompliance with the Artistic License. In particular, the Decoder Commander software did not include: “(1) the authors’ names; (2) JMRI copyright notices; (3) references to the COPYING file; (4) an identification of SourceForge or JMRI as the original source of the definition files; or (5) a description of how the files or computer code had been changed from the original source code.”⁷¹ Katzer/KAMIND had also modified DecoderPro file names without referencing the original JMRI files or explaining where they could be located.

Jacobsen sued Katzer and KAMIND in the United States District Court for the Northern District of California for copyright infringement on the basis of the defendants’ failure to abide by the terms of the Artistic License and sought a preliminary injunction to halt distribution of the Decoder Commander software.⁷² Jacobsen employed a similar litigation strategy to that followed by Harald Welte in the German courts, recognizing that equitable relief could be a powerful motivational tool while acknowledging that monetary damages arising from

If an entity redistributing the GPL licensed code for profit intentionally deleted copyright notices, such conduct would almost certainly generate a violation report, as in the AFPA litigation before the Paris appeals court and vigorously pursued by FSF France.

the unauthorized distribution of free software could be speculative.⁷³ Like Welte, Jacobsen also found an attorney dedicated to the cause, in

the person of Victoria Hall; she had regularly provided *pro bono* advice to the Electronic Frontier Foundation and was willing to assist Jacobsen at no charge.⁷⁴

The district court, however, held that the Artistic License was an “intentionally broad” nonexclusive license that was unlimited in scope. The district court thus concluded that no liability for copyright infringement could attach and denied Jacobsen’s request for a preliminary injunction:

...[T]he JMRI Project license provides that a user may copy the files verbatim or may otherwise modify the material in any way, including as part of a larger, possibly commercial software distribution. The license explicitly gives the users of the material, any member of the public, “the right to use and distribute the [material] in a more-or-less customary fashion, plus the right to make reasonable accommodations.” The scope of the nonexclusive license is, therefore, intentionally broad.⁷⁵

The court determined that to the extent Jacobsen had a potential remedy for Katzer’s unauthorized distribution of the DecoderPro files, the appropriate cause of action was breach of contract, not copyright infringement.

On appeal, the Federal Circuit vacated and remanded the district court’s decision. The appeals court noted, as a *practical* matter, that “[o]pen source licensing has become

⁶⁹ *Jacobsen*, 535 F.3d at 1376.

⁷⁰ See, e.g., <http://jmri.org/k/correspondence/20050308-KAM.pdf> (accessed on April 6, 2010).

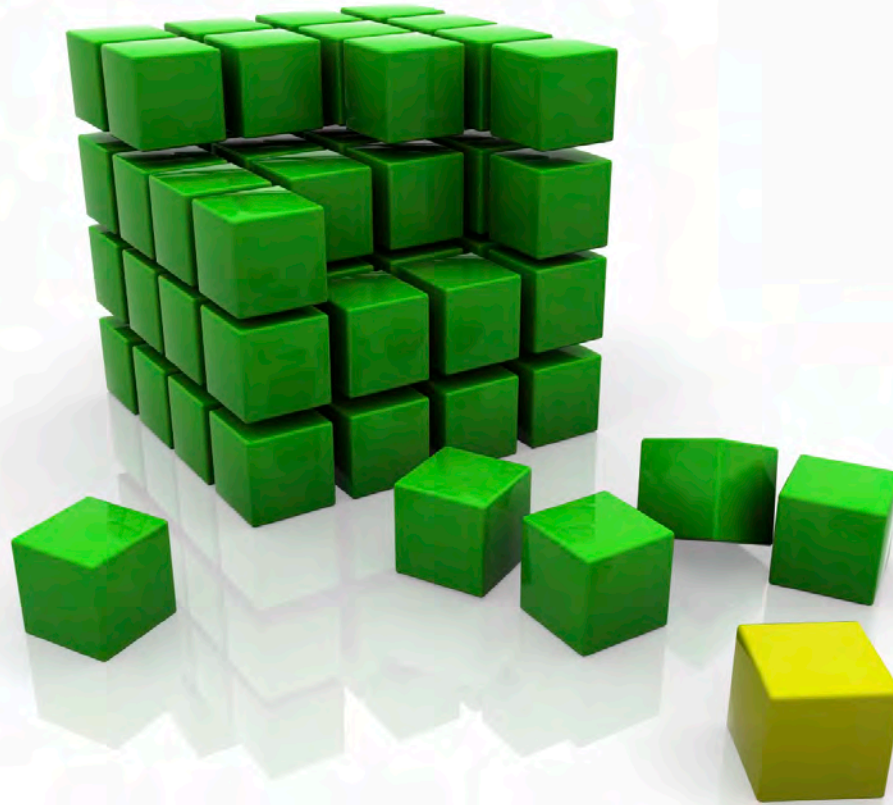
⁷¹ *Jacobsen*, 535 F.3d at 1376.

⁷² *Jacobsen v. Katzer*, No. 06-CV-01905 JSW, 2007 WL 2358628 (N.D. Cal. Aug. 17, 2007).

⁷³ See *Jacobsen*, 535 F.3d at 1383, n.6 (noting that “[a]t oral argument, the parties admitted that there might be no way to calculate any monetary damages under a contract theory”).

⁷⁴ Bruce Perens, “Bruce Perens: Inside Open Source’s Historic Victory,” <http://itmanagement.earthweb.com/features/article.php/3866316/Bruce-Perens-Inside-Open-Sources-Historic-Victory.htm> (February 22, 2010).

⁷⁵ *Jacobsen*, 2007 WL 2358628, at *7. Exhibit A to the Supplemental Declaration of Robert Jacobsen in Support of Motion for Preliminary Injunction states, *inter alia*, that “The intent of this document is to state the conditions under which a Package [*i.e.*, the collection of files distributed by the Copyright Holder, and derivatives thereof] may be copied, such that the Copyright Holder maintains some semblance of artistic control over the development of the package, while giving the users of the package the right to use and distribute the Package in a more-or-less customary fashion, plus the right to make reasonable modifications.” *Jacobsen*, No. 06-CV-01905 JSW (N.D. Cal. filed Nov. 17, 2006) (document no. 131-1).



a widely used method of creative collaboration that serves to advance the arts and sciences in a manner and at a pace that few could have imagined just a few decades ago.”⁷⁶ The court offered an illustration of the popularity and prevalence of software and other content distributed under public licenses:

For example, the Massachusetts Institute of Technology (“MIT”) uses a Creative Commons public license for an OpenCourseWare project that licenses all 1800 MIT courses. Other public licenses support the GNU/Linux operating system, the Perl programming language, the Apache web server programs, the Firefox web browser, and a collaborative web-based encyclopedia called Wikipedia. Creative Commons notes that,

by some estimates, there are close to 100,000,000 works licensed under various Creative Commons licenses. The Wikimedia Foundation, another of the *amici curiae*, estimates that the Wikipedia website has more than 75,000 active contributors working on some 9,000,000 articles in more than 250 languages.⁷⁷

The Federal Circuit also highlighted the benefits of open-source licenses “that range far beyond traditional license royalties,” including the expansion of market share for proprietary licensors who are willing to offer certain components at no charge, gain of reputation, and the ability to exploit additional development resources for more rapid and less costly product enhancements.⁷⁸

The court’s *legal* analysis focused on the issue of whether the terms of the Artistic License were *covenants to or conditions* of the license to use the DecoderPro software. Specifically, the Federal Circuit explained that if the license terms constituted conditions of use, then those conditions could limit the scope of the license and enable the licensor to bring a claim of copyright infringement against a licensee that acted outside its scope.⁷⁹ The court found that the Artistic License’s explicit reference to the creation of “conditions,” the use of the phrase “provided that” when characterizing the license grant, and the critical nature of the license requirements in helping the copyright holder benefit from the subsequent redistribution of the software, all supported the characterization of these terms as conditions.⁸⁰

⁷⁶ *Jacobsen*, 535 F.3d at 1378.

⁷⁷ *Id.*

⁷⁸ *Id.* at 1379-81 (further noting that “[t]he choice to exact consideration in the form of compliance with the open source requirements of disclosure and explanation of changes, rather than as a dollar-denominated fee, is entitled to no less legal recognition”).

⁷⁹ *Id.* at 1380.

⁸⁰ *Id.* at 1382; see also *id.* (“The clear language of the Artistic License creates conditions to protect the economic rights at issue in the granting of a public license.”).

Accordingly, the Federal Circuit determined that the district court had erred in failing to treat the express limitations in the Artistic License on an end-user's right to copy, distribute, and modify as conditions.⁸¹ The appellate court thus explicitly confirmed that the potential remedies available to a copyright owner for violation of an open-source license included those for breach of contract and copyright infringement.⁸² It directed the district court to reconsider the motion for preliminary injunction and make factual findings on whether Jacobsen had satisfied the

criteria for the issuance of equitable relief.⁸³

Upon remand, the court again denied the request for a preliminary injunction, and Jacobsen filed an appeal with the Federal Circuit.⁸⁴ Jacobsen also continued to pursue the district court litigation vigorously, filing a motion for summary judgment on October 30, 2009. Jacobsen engaged several expert witnesses to provide written testimony on the critical importance of copyright notices and attributions in open-source code and the irreparable harm caused by the ongoing distribution of

infringing open-source software; one such witness was Bruce Perens, the BusyBox developer discussed *supra*.⁸⁵

Following a ruling on both parties' motions for summary judgment that heavily favored Jacobsen, the parties settled the litigation on February 17, 2010. Rather than continuing to distribute the DetectorPro files and implementing remedial steps to comply with the Artistic License, Katzer/KAMIND consented to a permanent injunction prohibiting them from reproducing, modifying, or distributing JMRI materials. Katzer/KAMIND also

⁸¹ *Id.* at 1382.

⁸² In addition to his claim for copyright infringement, Jacobsen also alleged that Katzer had violated the Digital Millennium Copyright Act ("DMCA"). *Jacobsen v. Katzer*, No. C 06-01905 JSW, 2009 WL 4823021, at *1, 93 USPQ2d 1236 (N.D. Cal. Dec. 10, 2009). Jacobsen specifically alleged that notices and attributions in the original JMRI source code constituted "copyright management information" ("CMI") within the meaning of the DMCA, and that the defendants violated 17 U.S.C. § 1202(b) by removing those notices prior to re-distribution of the software. *Id.* at *7. The statute, which has as a primary objective protection of the integrity of CMI, includes the information in copyright notices, the name and other identifiers of the author of the work, the name and other identifiers of the copyright owner of the work, and terms and conditions for use of the work." 17 U.S.C. § 1202(c). Jacobsen contended that for purposes of the DecoderPro files, the "author's name, a title, a reference to the license and where to find the license, a copyright notice, and the copyright owner" were CMI. *Jacobsen*, 2009 WL 482301, at *7.

The district court agreed that this information was "CMI" and found that defendants' removal thereof met certain elements of a DMCA violation, but it did not resolve the ultimate issue prior to the parties' settlement of the case. *Id.* Nevertheless, the case highlights the potential applicability of the DMCA in instances where copyright or licensing notices have been removed; criminal penalties including fines and imprisonment could result from the willful removal of CMI "for purposes of commercial advantage." 17 U.S.C. § 1202.

⁸³ *Id.*

⁸⁴ JMRI provides a detailed chronology of the *Jacobsen* litigation at <http://jmri.sourceforge.net/k/History.shtml> (accessed on April 6, 2010).

⁸⁵ Perens' testimony is available at <http://perens.com/works/testimony/PerensJMRI.pdf> (accessed on April 6, 2010); see Bruce Perens, "Bruce Perens: Inside Open Source's Historic Victory," <http://itmanagement.earthweb.com/features/article.php/3866316/Bruce-Perens-Inside-Open-Sources-Historic-Victory.htm> (February 22, 2010).



agreed to pay Jacobsen the sum of \$100,000.⁸⁶ JMRI independently forswore the Artistic License and adopted the GPL Version 2 for all of its applications.⁸⁷

Recent Enforcement Actions in U.S. Courts Continue to Follow Patterns Formed in European Courts

In December 2009, again represented by the SFLC, Andersen and the

...efforts to enforce free and open-source licenses in the United States are more spirited than ever, with disciplined organizations of developers and counsel often ready and willing to participate on behalf of the plaintiff.

Software Freedom Conservancy⁸⁸ sued Best Buy Co., Samsung Electronics America, and twelve other companies in the SDNY for copyright infringement arising from their redistribution of the BusyBox program.⁸⁹ As of the date of this article, the case is proceeding and the district court recently set a schedule for standard pre-trial and discovery activities. Notably, the defendants in *Best Buy* have reserved their right to seek a jury trial on the issues, perhaps believing that the laymen

on a jury would look unfavorably on this extension of free software philosophy; this would be the first federal case in which a jury would serve as decision-maker for an open-source enforcement action.

Two additional procedural aspects of this case are noteworthy, even as the case remains in its early stages. First, *Best Buy* emphasizes that open-source licenses are being enforced not only against software providers and hardware manufacturers, but distributors of devices that contain open-source software. Best Buy, for example, is alleged to have distributed a “Blu-ray Disc Player” infringing Andersen’s copyright in the BusyBox code. Discovery in the case will likely show that Best Buy had no role in determining which software or firmware was used in the disc player or was even aware of its inclusion.

Second, counter to the reaction to earlier cases filed by the SFLC, only one of fourteen defendants in *Best Buy* settled the suit before the due date for formally responding to the complaint. The remaining thirteen defendants each filed a timely “answer” under Federal Rule of Civil Procedure 12(a). No defendant filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), alleging, for example, that the GPL was unenforceable as a matter of law. The defendants’ procedural strategy suggests that they are cognizant of earlier decisions upholding the enforceability of open-source licenses.

But, the defendants have denied copyright infringement and raised numerous affirmative defenses yet to be considered by a federal court

in a claim seeking the enforcement of a free or open-source license. For example, Best Buy raised seven affirmative defenses that include a challenge to the plaintiffs’ standing to bring the suit and a “fair use” defense. Best Buy has also filed a counterclaim seeking a declaratory judgment that it does not infringe any copyright in the BusyBox code. This forceful approach may be the result of Best Buy observing the previously referenced disputes within the open-source community regarding the ownership of such copyright; it will be enlightening to see who Best Buy names to its witness list.

This case is certain to be closely watched by the open-source community and the corporate users of their software.

Conclusion

Since 2005, authority supporting the enforceability of open-source licenses in the United States has matured, in large part due to groundbreaking and unwavering decisions by European courts. So too have the recognized scope of remedies available to the licensor and, perhaps, even the range of other affected parties who can pursue such enforcement. Although the European decisions have not been cited directly in opinions by federal courts, they certainly have left their mark on our jurisprudence.

Moreover, the zealous and dedicated open-source advocates that aided enforcement litigation in European courts through both technical and *pro bono* legal services have offered the same assistance in analogous federal cases. And efforts to enforce free and open-source licenses in the

⁸⁶ *Jacobsen*, No. 06-CV-01905 JSW (N.D. Cal. filed Feb. 18, 2010) (document no. 402).

⁸⁷ <http://www.jmri.org/help/en/html/doc/Technical/index.shtml#use> (accessed April 6, 2010).

⁸⁸ Founded in 2006, the Software Freedom Conservancy is an outgrowth of the Software Freedom Law Center and is a self-described “fiscal sponsor” for open source projects that elect to transfer their assets to this 501(c)(3) organization. <http://conservancy.softwarefreedom.org/news/2006/apr/03/conservancy-launch/> (April 3, 2006). The Conservancy performs financial and administrative services for the projects and asserts that its corporate shield will protect the software contributors from personal liability. <http://conservancy.softwarefreedom.org/overview/> (accessed on April 6, 2010). “All of these benefits are currently provided for free.” *Id.* Busy Box was one of the first projects to join the Conservancy. <http://conservancy.softwarefreedom.org/news/2006/apr/03/conservancy-launch/> (accessed on April 6, 2010).

⁸⁹ *Software Freedom Conservancy, Inc. v. Best Buy Co., Inc.*, No. 1:09cv10155 SAS (S.D.N.Y. Dec. 14, 2009).

United States are more spirited than ever, with disciplined organizations of developers and counsel often ready and willing to participate on behalf of the plaintiff. The open-source community will exploit the momentum gained from their achievements; they cannot afford to lose credibility, or the impetus for many licensees to comply may be diminished.⁹⁰ As courts around the world continue to decide the vast array of complex contractual and intellectual property questions surrounding the interpretation of and compliance with open-source licenses, the marks of early decisions by European courts will remain.

But there are many issues that require deeper exploration. What will become the conventional standard for quantifying actual monetary damages for copyright infringement suffered by a copyright owner of software distributed solely under an open-source license? May a copyright owner of open-source software seek the destruction or seizure of equipment and hardware on which infringing code is embedded? Under what circumstances will the terms of a free or open-source license be deemed to be covenants but not conditions enabling a related claim for copyright infringement? These and many other questions remain.

And perhaps the most intriguing question of all also remains, for those who must understand and apply the principles to their technology with a degree of certainty as to their validity: On which continent will jurisprudence regarding the enforcement of free and open-source licenses develop most rapidly? Counsel on both sides of the Atlantic Ocean are advised to track carefully the work of their colleagues.

⁹⁰ CBS Interactive, "GPL Defenders Say: See You in Court," http://news.cnet.com/GPL-defenders-say-See-you-in-court/2100-7344_3-6210837.html (October 1, 2007) (Daniel Ravicher, counsel in *Monsoon* and co-founder of SFLC, observed "[i]f you start getting a reputation for being a pansy, then people are going to conclude they don't have to do anything").

Commentary: Cloud Computing Tips for Broker-Dealers, ATs and ECNs

By
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This article was originally published in the April 2010 issue of *Traders Magazine*.



Cloud computing has burst onto the scene. Broker-dealers, ATs and ECNs see nothing but sunny skies ahead. This article clears up some of the often nebulous deal terms each should consider before sending trade data to the clouds.

What In The World Is Cloud Computing?

The “cloud” is made up of software and hardware service providers invisible to the traders using them. Traders see only the front-end website. Broker-dealers, ECNs and ATs timeshare the servers, networks, administrators, and software developers. Traders enjoy the benefits of more services, more flexibility, scalability, more access to liquidity and faster executions. All this comes without broker-dealers, ECNs and ATs having to incur large upfront capital expenditures for hardware and software requiring frequent

upgrades and without having to hire and retain costly IT staff. The cloud has expanded beyond traditional IT services, and now offers a broad range of market data, blotters, portfolio models, analytic tools, dark pools, trading algorithms, and aggregator services.

Choosing Service Partners In The Cloud?

A search for a partner begins with structured due diligence. Examine qualifications, technology, staff, management style and past work of potential service partners. Obtain and review proposals that include detailed descriptions for any services to be provided. Regulated entities that have been through the outsourcing exercise will attest to the many technical and legal obstacles involved in picking the right service partners. A wrong choice can result in significant downstream costs, reputational damage, regulatory liability, or worse. Broker-dealers, ECNs, and ATs cannot sacrifice performance, increase trade latency, tolerate downtime, skimp on compliance, or injure their customers with technical snafus.

Many large cloud service providers purport to offer “industry standard” service or technology agreements. Make no mistake. These agreements are complex and rife with legal traps. They need to be carefully negotiated

with advice of experienced in-house or outside counsel. The devil is in the details, and it pays to have a negotiating team with IT know-how and regulatory and software expertise. Broker-dealers, ECNs and ATSs must avoid letting their judgment be clouded by the lure of potential cost savings in using service providers. They need to think carefully about the following issues when they negotiate cloud computing agreements.

How Do I Make Sure The Cloud Meets Expectations?

Clear specifications in the contract should detail how software is to perform and interact with hardware and other software. The client may want the cloud provider to agree to each and every representation made by the cloud provider's sales staff. The cloud provider, in contrast, may seek to provide performance obligations that meet loose definitions not always tailored to the client's needs. The cloud provider should define "bugs," satisfactory levels of "bugs," what events are deemed a "failure," and remedies for a "failure" occurring. Think "fix" as opposed to mere restoration of service. Think service level obligations and penalties if they are not met. Beta testing provisions may also be included to ensure that the software—before a global rollout and commitment—meets minimum requirements during the beta phase. The negotiation process is an opportunity for the client to "smoke out" the cloud and determine how confident the cloud is about the performance of its products.

How To Protect The Data In The Cloud?

The client may want guarantees that its data will remain uncorrupted and

A "cloud computing" structure could involve significant software integration between the client and the cloud, perhaps even sharing source code.

secure, during both data transmission and storage. Further, the client may request cloud service providers to agree not to share information that reveals the identity of customers, trading patterns or aggregate trades. The client should require that the cloud maintain confidentiality and renounce any ownership interest in any data received from the client or its customers.

How To Handle Regulatory Requirements In The Cloud?

Broker-dealers have been regulated by the SEC since its creation in 1934. ATSs have been directly regulated by the SEC only since 1998, when the SEC promulgated Regulation ATS, Rules 300-303. Rule 301, for example, specifies requirements for ATSs, including: capacity estimation, stress testing, security reviews, oversight procedures, disaster recovery plans, annual auditing, and filing and periodically amending Form ATS to report material system outages or changes. FINRA imposes additional regulations on broker-dealers and ATSs. The operations of broker-dealers, ECNs, and ATSs fall into two categories—those that cannot be outsourced, and those that can with proper supervision. Broker-dealers cannot outsource regulatory

responsibilities. The cloud should only perform ministerial activities for the broker-dealer. Except for limited back office contact, the cloud should not communicate with a broker-dealer's customers. The broker-dealer client must monitor and supervise any outsourced functions on an ongoing basis pursuant to comprehensive written supervisory procedures (WSPs).

Neither the SEC nor FINRA has made clear how much, if any, responsibility falls directly on the cloud service providers, themselves. As the line between the client and the cloud blurs, both the SEC and FINRA may conclude that policy considerations weigh heavily in favor of subjecting the underlying providers to direct regulation. Such a change would likely take an act of Congress because regulatory jurisdiction over the cloud is unclear. For now the regulators reach the clouds through the backdoor, requiring broker-dealers to put certain provisions in their outsourcing agreements. For example, agreements normally need to provide regulators access to the client's data at the cloud service provider.

Who Is Responsible When The Cloud Crashes?

Clouds burst. Systems glitch. Networks crash. Parties need to agree on how liability for resulting damages, both actual and consequential, will be apportioned. The parties will need to decide if liability should only arise from willful misconduct or if a negligence or gross negligence standard is more appropriate. Typically, the cloud service provider may insist on a bold faced disclaimer and a modest cap on its liability. Such limitations can be outright rejected or countered with carve outs for failures to meet

support obligations that clearly fall in the hands of the cloud. Given that traders, as end-users, will not necessarily have a direct relationship, much less a direct agreement, with the cloud, broker-dealers, ECNs, and ATSs will bear the brunt of their customers' fury if the cloud fails. The cloud will typically insist on disclaiming any liability for consequential damages; at the very least, clients could seek a carve-out for the cloud's gross negligence or willful misconduct.

A "cloud computing" structure could involve significant software integration between the client and the cloud, perhaps even sharing source code. The cloud may want full indemnification from any claims or lawsuits arising out of use of the software on its servers. Clients should seek to limit indemnifications to claims covering acts or omissions that are within their control. In turn, clients should also seek

indemnification from the cloud for any breach of a covenant to provide support level obligations and to ensure that products will perform in accordance with their specifications and not infringe the intellectual property rights of others. The parties may also consider insurance policies to cover indemnities, to mitigate hefty potential damages in the event of an infringement finding. The relative economics of the transaction appropriately will play a big part in how liabilities are allocated between the parties.

Who Owns The Intellectual Property In The Cloud?

Clients and cloud service providers might cross-license software to provide an integrated solution, for example, when both the client and service provider have intellectual property that the other can use. Under a cross-license, each party gives its counterparty a license to use

its respective technology. Each will want to maintain full ownership to all of its intellectual property. Clients may seek a fully paid, perpetual license, to any software developed by or with the cloud in connection with providing services under the agreement.

What If The Relationship With The Cloud Sours?

Clients will need to plan for the termination of service provider agreements where services repeatedly fail or regulatory changes cannot be accommodated. The cloud may create a tangled web that makes terminating a relationship difficult. Availability of transition services should be a consideration at the time of entering any agreement. Ideally, services should be portable with minimal costs when moving to a new provider. The agreement should allocate costs and require the cloud to provide its full cooperation



in the transition. Moreover, the cloud and the client should anticipate how transition and termination provisions could be interpreted in the event of either's insolvency.

This article casts a few rays of light through the clouds. These transactions are not one-size-fits-all. They require careful planning and thoughtful negotiations. As more broker-dealers, ECNs, and ATSS look to the clouds, the industry will

face increased regulatory scrutiny, intellectual property lawsuits, and technical issues. Clients need to meticulously analyze, understand, and provide for the potential issues when clouds are selected and agreements negotiated.

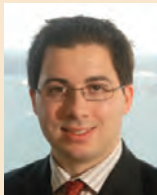
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Judicially Re(de)fining Software Patent Eligibility: A Survey of Post-*Bilski* Jurisprudence

By
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I. Introduction

On June 1, 2009, the United States Supreme court granted certiorari to hear the landmark *Bilski v. Kappos* case. Awaiting the Supreme court's decision, some district courts have exercised restraint by delaying their ruling on patent eligibility issues until the perceived uncertainty clears. For instance, one court has explained that "[a]fter the Supreme court issues its *Bilski* opinion, this court will likely have clear direction on the precise standard to be applied in evaluating the patentability of method claims. With that guidance, the court will be able to efficiently consider and evaluate [the accused infringer's] argument that the [patent-at-issue] is invalid." *Lincoln Nat'l Life Ins. Co. v. Transamerica Fin. Life Ins. Co.*, No. 1:08-CV-135-JVBRBC, 2010 WL 567993, at *1 (N.D. Ind. Feb. 12, 2010) (citing *Arrivalstar S.S. v. Canadian Nat'l Ry. Co.*, No. 08 C 1086, 2008 WL 2940807, at *2 (N.D. Ill. July 25, 2008)). This may be a prudent course, as the Federal Circuit court of Appeals even "recognize[d] that the Supreme court may ultimately decide to alter or perhaps even set aside [the *Bilski* machine-ortransformation] test to accommodate emerging technologies." *In re Bilski*, 545 F.3d 943, 956 (Fed. Cir. 2008) (en banc)

However, other courts have interpreted the Federal Circuit's guidance in a manner that, if adopted

by more courts, could cause material invalidity challenges to many patents. See, e.g., *CyberSource Corp. v. Retail Decisions, Inc.*, No. C 04-03268, 2009 WL 815448 (N.D. Cal. May 26, 2009); *Every Penny Counts, Inc. v. Bank of America Corp.*, No. 2:07-cv-042, slip op. (M.D. Fla. May 27, 2009); *DealerTrack, Inc. v. Huber*, 657 F. Supp. 2d 1152, 1153 (C.D. Cal. July 7, 2009); see also *Assoc. for Molecular Pathology v. USPTO*, No. 09 Civ. 4515, 2010 U.S. Dist. LEXIS 30629 (S.D.N.Y. March 29, 2010). This paper briefly reviews the Federal Circuit's *In re Bilski* decision and details the Federal Circuit's and district courts' responses to it.

II. *In re Bilski* in Brief

The claim at issue in *In re Bilski* was directed to "a method of hedging risk in the field of commodities trading." *In re Bilski*, 545 F.3d at 949. The claim read as follows:

A method for managing the consumption risk costs of a commodity sold by a commodity provider at a fixed price comprising the steps of:

- (a) initiating a series of transactions between said commodity provider and consumers of said commodity wherein said consumers purchase said commodity at a fixed rate based upon historical averages, said



fixed rate corresponding to a risk position of said consumer;

- (b) identifying market participants for said commodity having a counterrisk position to said consumers; and
- (c) initiating a series of transactions between said commodity provider and said market participants at a second fixed rate such that said series of market participant transactions balances the risk position of said series of consumer transactions. *Id.*

The Federal Circuit held that the “machine-or-transformation” test is the sole analysis to use when determining whether a process qualifies as patentable subject matter. See *In re Bilski*, 545 F.3d 943, 961 (Fed. Cir. 2008) (en banc). The test requires courts and the United States Patent and Trademark Office to ensure that a process claim either is tied to a “particular” machine or transforms an article into a different state or thing in order to satisfy patent eligibility under 35 U.S.C. §101. See *Id.* The Federal

Circuit’s test also requires that the use of a machine or transformation provides “meaningful limits” on the claim’s scope and not merely involve “insignificant post-solution activity.” *Id.*

As no “machine” was present in the claim at issue, the court declined to give further guidance on what constitutes a “particular” machine. *Id.* at 962 (“We leave to future cases the elaboration of the precise contours of machine implementation, as well as the answers to particular questions, such as whether or when recitation of a computer suffices to tie a process claim to a particular machine.”).

The court did, however, explain that “a process for chemical or physical transformation of *physical objects or substances* is patent-eligible subject matter.” *Id.* (emphasis in original). To reach the threshold of a “electronic transformation,” the Federal Circuit noted that [s]o long as the claimed process is limited to a practical application of a fundamental principle to transform specific data, and the claim is limited to a visual depiction that represents specific physical

objects or substances, there is no danger that the scope of the claim would wholly pre-empt all uses of the principle. *Id.* at 963. On the other hand, “purported transformations” that only add a data gathering step to an algorithm or that allegedly transform “public or private legal obligations or relationships, business risks, or other such abstractions” will not satisfy the transformation prong of the machine-or-transformation test. See *Id.* The court stressed that such alleged transformations “cannot meet the test because they are not physical objects or substances, and they are not representative of physical objects or substances.” *Id.* Nonetheless, the court “decline[d] to adopt a broad exclusion over software or any other such category of subject matter beyond the exclusion of claims drawn to fundamental principles set forth by the Supreme Court.” *Id.* at 960.

The Federal Circuit held the claim at issue invalid for claiming, in whole, non-statutory subject matter because the claim admittedly was not tied to

any machine and only purportedly transformed “public or private legal obligations or relationships, business risks, or other such abstractions....” *Id.* at 963-64.

III. Post-*In re Bilski* Jurisprudence

A. Federal Circuit Cases

1. *In re Ferguson*

The claims at issue in *In re Ferguson* were directed to a process for “marketing a product ... using a shared marketing force” and a “paradigm for marketing a company....” *In re Ferguson*, 558 F.3d 1359, 1361 (Fed. Cir. 2009). The claims read as follows:

[claim 1] A method of marketing a product, comprising: developing a shared marketing force, said shared marketing force including at least marketing channels, which enable marketing a number of related products;

using said shared marketing force to market a plurality of different products that are made by a plurality of different autonomous producing company, so that different autonomous companies, having different ownerships, respectively produce said related products;

obtaining a share of total profits from each of said plurality of different autonomous producing companies in return for said using; and

obtaining an exclusive right to market each of said plurality of products in return for said using.

[claim 24] A paradigm for marketing software, comprising: a marketing company that

The Federal Circuit held that the “machine-or-transformation” test is the sole analysis to use when determining whether a process qualifies as patentable subject matter.

markets software from a plurality of different independent and autonomous software companies, and carries out and pays for operations associated with marketing of software for all of said different independent and autonomous software companies, in return for a contingent share of a total income stream from marketing of the software from all of said software companies, while allowing all of said software companies to retain their autonomy. *Id.*

The Federal Circuit generally agreed with the Board of Patent Appeals and Interferences (BPAI) that the claims at issue were not drawn to statutory subject matter. See *Id.* at 1366.

Regarding the method claims, the court proclaimed that its “recent decision in *Bilski* is dispositive” and determined that the method claims failed to satisfy the machine-or-transformation test. *Id.* at 1366. The applicants argued that the “shared marketing force” limitation constituted a sufficient tie to a particular machine. *Id.* at 1364. Relying on *In re Nuijten*, the Federal Circuit applied a nineteenth century definition of machine, that is, a

“concrete thing, consisting of parts, or of certain devices and combination of devices ... includ[ing] every mechanical device or combination of mechanical powers and devices to perform some function and produce a certain effect or result.” *Id.* (quoting *In re Nuijten*, 500 F.3d 1346, 1355 (Fed. Cir. 2007) (quoting *Burr v. Duryee*, 68 U.S. (1 Wall.) 531, 570, 17 L. Ed. 650 (1863); *Corning v. Burden*, 56 U.S. (15 How.) 252, 267, 14 L. Ed. 683 (1853)). Using this definition, the court held that “a marketing force is not a machine or apparatus.” *Id.*

In addition, the Federal Circuit explained that the claims did not “transform any article into a different state or thing.” *Id.* Specifically, methods of “organizing business or legal relationships in the structuring of a sales force (or marketing company)” do not transform “physical objects or substances” or “representati[ons] of physical objects or substances.” *Id.*

Regarding the “paradigm” claims, the court held that they do not fit into any of the four categories of statutory subject matter under 35 U.S.C. §101: process, machine, article of manufacture, or composition of matter. See *Id.* at 1365-66. The court held the claims were: (i) not “directed to processes, as ‘no act or series of acts’ is required”; (ii) not a “manufacture” because a marketing company “cannot itself be an ‘article [] resulting from the process of manufacture’”; (iii) not a “machine” as “you cannot touch the company”; and (iv) “certainly not a composition of matter.” *Id.* at 1366.

2. *Prometheus Labs., Inc. v. Mayo Collaborative Servs.*

The claims at issue in *Prometheus Labs* were directed to “methods for calibrating the proper dosage of thiopurine drugs, which are used for treating both gastrointestinal

and nongastrointestinal autoimmune diseases.” *Prometheus Labs., Inc. v. Mayo Collaborative Servs.*, 581 F.3d 1336, 1339 (Fed. Cir. 2009). The representative claim reads as follows:

A method of optimizing therapeutic efficacy for treatment of an immunemediated gastrointestinal disorder, comprising:

(a) administering a drug providing 6-thioguanine to a subject having said immune-mediated gastrointestinal disorder; and

(b) determining the level of 6-thioguanine in said subject having said immune-mediated gastrointestinal disorder,

wherein the level of 6-thioguanine less than about 230 pmol per 8×10^8 red blood cells indicates a need to increase the amount of said drug subsequently administered to said subject; and

wherein the level of 6-thioguanine greater than about 400 pmol per 8×10^8 red blood cells indicates a need to decrease the amount of said drug subsequently administered to said subject.
Id. at 1340.

The Federal Circuit “made clear that the patent eligibility of a claim as a whole should not be based on whether selected limitations constitute patent-eligible subject matter.” *Id.* at 1343 (citing *Bilski*, 545 F.3d at 958 (citing *Diamond v. Diehr*, 450 U.S. 175, 188 (1981); *Parker v. Flook*, 437 U.S. 584, 594 (1978))). For determining whether a process is eligible for patenting, the court reaffirmed the machine-or-transformation test as the sole test for such inquiry. See *Id.* at 1342-43.

The Federal Circuit found that the claims are indeed transformative as that “[t]he transformation is of the

The Federal Circuit “made clear that the patent eligibility of a claim as a whole should not be based on whether selected limitations constitute patent-eligible subject matter.”

human body following administration of a drug and the various chemical and physical changes of the drug’s metabolites that enable their concentrations to be determined.” *Id.* Unlike mere “data-gathering steps,” “[t]he asserted claims are in effect claims to method of treatment, which are always transformative when a defined group of drugs is administered to the body to ameliorate the effects of an undesired condition.” *Id.*

The court emphasized that “[t]he invention’s purpose to treat the human body is made clear in the specification and the preambles of the asserted claims.” *Id.* The court noted that the administration of drugs, like the ones embodied in the claims, causes “the human body ... to undergo[] a transformation.” *Id.* (“The drugs do not pass through the body untouched without affecting it.”) In addition, the court described the “determining” step as transformative because the levels could not “be determined by mere inspection. [Rather, s]ome form of manipulation ... is necessary to extract the metabolites from a bodily sample and determine their concentration.” *Id.* at 1347.

The Federal Circuit focused on whether the transformation was “central[t]o the purpose of the

claims...” *Id.* The court found the transformation had this attribute because “a significant part of the claimed method of treatment” constituted the transformative subject matter. *Id.* The court further explained that inclusion of mental steps does not “negate the transformative nature of prior steps.” *Id.* at 1348. Such analysis can be simplified to a single question: “What did the applicant invent?” *Id.* (quoting *In re Grams*, 888 F.2d 835 (Fed. Cir. 1989) (citation omitted)). In the present case, the court answered “a series of transformative tests that optimizes efficacy and reduces toxicity of a method of treatment for particular diseases using particular drugs.” *Id.*

The court did not analyze the claims under the machine prong of the test because it found that the claimed methods satisfy the transformation prong. See *Id.* at 1346.

B. District Court Cases

I. *Transamerica Life Ins. Co. v. Lincoln Nat’l Ins. Co.*

The claim at issue in *Transamerica Life Ins. Co.* was directed to “a five-step computerized method for administering a variable annuity plan having, *inter alia*, a guaranteed minimum payment feature associated with a systematic withdrawal program.” *Transamerica Life Ins. Co. v. Lincoln Nat’l Life Ins. Co.*, No. C 06-110-MWB, 2010 WL 785905, at *2 (N.D. Iowa March 8, 2010). The claim read as follows:

35. A computerized method for administering a variable annuity plan having a guaranteed minimum payment feature associated with a systematic withdrawal program, and for periodically determining an amount of a scheduled payment to be made to the owner under the plan, comprising the steps

of: a) storing data relating to a variable annuity account, including data relating to at least one of an account value, a withdrawal rate, a scheduled payment, a payout term and a period of benefit payments; b) determining an initial scheduled payment; c) periodically determining the account value associated with the plan and making the scheduled payment by withdrawing that amount from the account value; d) monitoring for an unscheduled withdrawal made under the plan and adjusting the amount of the scheduled payment in response to said unscheduled withdrawal; and e) periodically paying the scheduled payment to the owner for the period of benefit payments, even if the account value is exhausted before all payments have been made. *Id.*

The alleged infringer moved for leave to amend its pleadings to include new invalidity defenses because of the Federal Circuit's holding in *In re Bilski*. See *Transamerica Life Ins.*

Co v. Lincoln Nat'l Life Ins. Co., 590 F. Supp. 2d 1093, 1097 (Fed. Cir. 2008). While the court did not grant leave to amend, it did interpret the Federal Circuit's decision. See *Id.* at 1103. In particular, the court stated that the "machine-or-transformation test" is the sole test to determine the patent eligibility of method claims. As a result, the court explained that the "Freeman- Walter-Abele" and "useful, concrete, and tangible result" tests are no longer good law and their associated case law is abrogated. *Id.* Nonetheless, the court did not grant the motion because the "court understands *Bilski* to clarify which one of several tests previously applied by the courts should apply to determine 'patent-eligible subject matter,' rather than to make a new test out of whole cloth." *Id.*

2. *King Pharm., Inc. v. Eon Labs, Inc.*

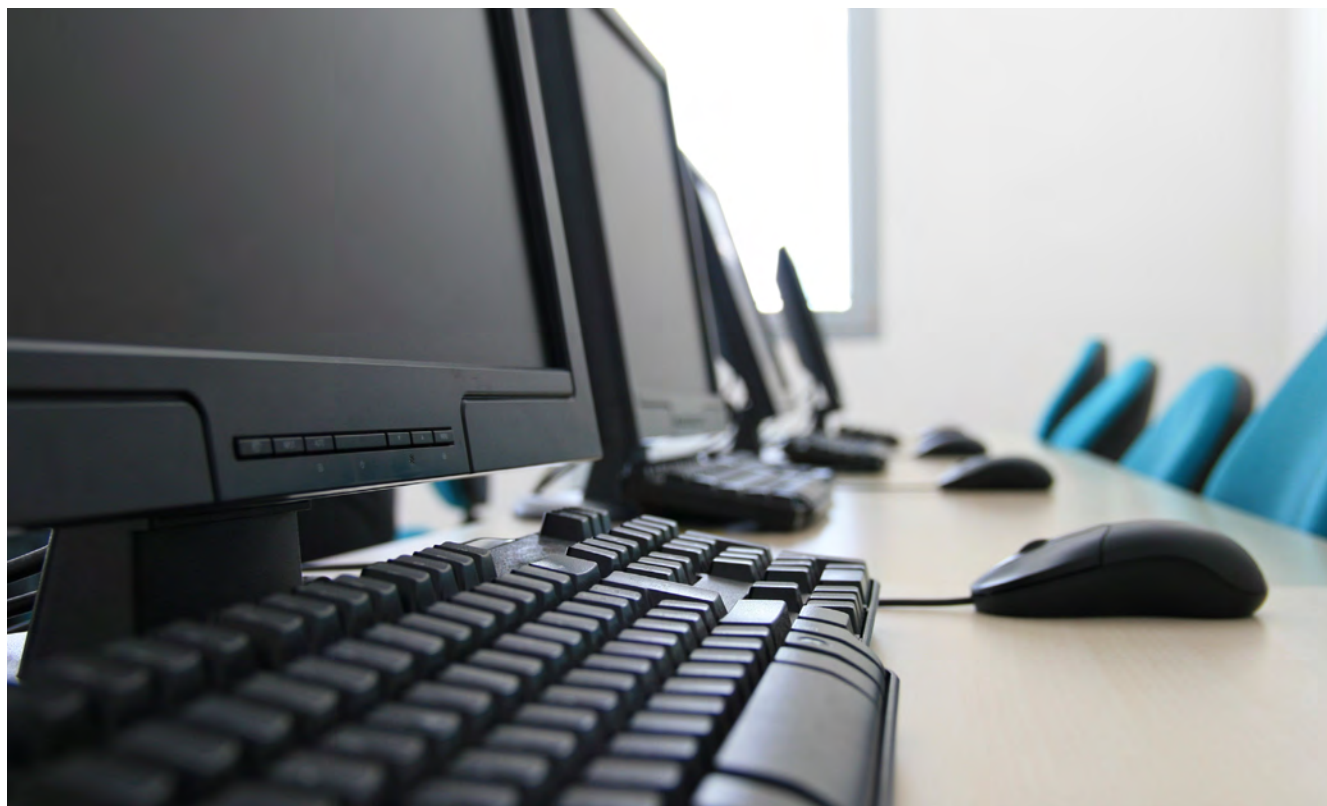
The claims at issue in *King Pharm., Inc.* were directed to a method of "administering metaxalone to a patient with food." *King Pharms., Inc. v. Eon Labs, Inc.*, 593 F. Supp. 2d 501,

506 (E.D.N.Y. 2009). The claims read as follows:

1. A method of increasing the oral bioavailability of metaxalone to a patient receiving metaxalone therapy comprising administering to the patient a therapeutically effective amount of metaxalone in a pharmaceutical composition with food.

21. The method of claim 1, further comprising informing the patient that the administration of a therapeutically effective amount of metaxalone in a pharmaceutical composition with food results in an increase in the maximal plasma concentration (C_{max}) and extent of absorption (AUC_(last)) of metaxalone compared to administration without food. *Id.* at 506, 512.

The court did not review independent claim 1 for whether it claims statutory subject matter, as it found claim 1 unpatentable as anticipated by the prior art. See *Id.*



at 506-10. The court did, however, analyze claim 21, which depends from independent claim 1, under *Bilski*. See *Id.* at 512-13.

In its analysis, the court seemed to imply that because the limitation of the independent claim was anticipated and the dependent claim wholly contained nonstatutory subject matter, the dependent claim can be invalid under 35 U.S.C. §101. See *Id.* (“Because the food effect is an inherent property of the prior art and, therefore, unpatentable, then informing a patient of that inherent property is likewise unpatentable.”) The court held that dependent claim 21 failed the machine-or-transformation test, as “the act of informing another person of the good effect of metaxalone does not transform the metaxalone into a different state or thing.” *Id.* The court also noted that the claim’s recitation of “a particular transformation ... must not constitute mere ‘insignificant postsolution activity.’” *Id.* at 513 (quoting *In re Bilski*, 545 F.3d at 957 (quoting *Parker v. Flook*, 437 U.S. 584, 590 (1978))). Accordingly, the court found claim 21 invalid. See *Id.* at 515.

3. *Fort Props., Inc. v. Am. Master Lease, LLC*

The claims at issue in *Fort Props., Inc.* were directed to a “method for creating an investment instrument out of real property.” *Fort Props., Inc. v. Am. Master Lease, LLC*, 609 F. Supp. 2d 1052, 1053 (C.D. Cal. 2009). The independent claims read as follows:

- I. A method of creating a real estate investment instrument adapted for performing tax-deferred exchanges comprising:
 - aggregating real property to form a real estate portfolio;
 - encumbering the property in the real estate portfolio with a master agreement; and

creating a plurality of deedshares by dividing title in the real estate portfolio into a plurality of tenant-in-common deeds of at least one predetermined denomination, each of the plurality of deedshares subject to a provision in the master agreement for reaggregating the plurality of tenant-in-common deeds after a specified interval.

* * *

11. A method of performing a tax-deferred exchange of investment real estate under .sctn. 1031 of the Internal

In its analysis, the court seemed to imply that because the limitation of the independent claim was anticipated and the dependent claim wholly contained nonstatutory subject matter, the dependent claim can be invalid under 35 U.S.C. §101.

Revenue Code comprising:

- transferring a first interest in investment real estate having a first value and being subject to a first debt from an exchanger to a third party;
- using the third party to transfer title to the first interest in investment real estate to a buyer in exchange for money, proceeds of the transfer of the title to the

first interest being held by the third party;

identifying deedshares having a second value equal to or greater than the first value and subject to a second debt equal to or greater than the first debt as a replacement property within a specified number of days of transferring title to the first interest in investment real estate, the deedshares comprising an undivided tenant-in-common interest in investment real estate that is subject to a master agreement including a provision reaggregating title to the investment real estate represented by the deedshares at a specified time;

closing the sale of the deedshares within a second specified number of days of transferring title to the first interest in investment real estate; and

transferring the deedshares and the second debt from the third party to the exchanger.

* * *

22. A method of creating a real estate investment instrument adapted for performing tax-deferred exchanges comprising:

acquiring real property;

encumbering the real property with a master agreement; and

creating a plurality of deedshares by dividing title in the real property into a plurality of tenant-in-common deeds of at least one predetermined denomination, each of the plurality of deedshares subject to a provision for reaggregating the plurality of tenant-in-common deeds after a specified interval.

* * *

32. A method of creating a real estate investment instrument adapted for performing tax-deferred exchanges comprising: acquiring real property; encumbering the real property with a master agreement; and using a computer to generate a plurality of deedshares by generating a plurality of tenant-in-common deeds of at least one predetermined denomination that divide title in the real property into a plurality of tenant-in-common interests, each of the plurality of tenant-in-common deeds being subject to a provision in the master agreement for reaggregating the plurality of tenant-in-common deeds after a specified interval.

U.S. Pat. No. 6,292,788 B1.

The court applied the machine-or-transformation test to the claims at issue. See *Fort Props., Inc.*, 609 F. Supp. 2d at 1054-56.¹ For process claims, the court explained that the patentee must show that her “claim is tied to a particular machine” or “transforms an article.” *Id.* at 1055 (quoting *Bilski*, 545 F.3d at 961). Furthermore, “two considerations were important to [this] analysis...” *Id.* “First, ‘the use of a specific machine or transformation of an article must impose meaningful limits on the claim’s scope to impart patent-eligibility.’ Second, ‘the involvement of the machine or transformation in the claimed process must not merely be insignificant extra-solution activity.’” *Id.* (quoting *Bilski*, 545 F.3d at 961-62).

For the machine prong, the patentee “acknowledged during” prosecution and in its opposition brief that “the recited methods need not be performed by a computer.” *Id.*



(citations omitted).

For the transformation prong, the court found that, like in *Bilski*, the claims at issue “involve only the transformation or manipulation of legal obligations and relationships.” *Id.* at 1056. In particular, those claims “only transform or manipulate legal ownership interests in real estate” and, therefore, “[u]nder *Bilski*, the [c]ourt [could not] find that those claims transform an article or thing.” *Id.* The court rejected the patentee’s argument that “[t]he creation of the deedshare certainly qualifies as the ‘transformation and reduction of an article,’” as deedshares do not “represent physical objects or substances.” *Id.* (citing *Bilski*, 545 F.3d at 963). As a result, the court held the claims at issue invalid under *Bilski*. See *Id.*

4. *CyberSource Corp. v. Retail Decisions, Inc.*

The claims at issue in *CyberSource Corp.* were directed to “a method and system for detecting fraud in a credit card transaction between a consumer and a merchant over the internet.” 620 F. Supp. 2d at 1070. The claims read as follows:

2. A computer readable medium containing program instructions

for detecting fraud in a credit card transaction between a consumer and a merchant over the Internet, wherein execution of the program instructions by one or more processors of a computer system causes the one or more processors to carry out the steps of:

- a) obtaining credit card information relating to transactions from the consumer; and
- b) verifying the credit card information based upon values of plurality of parameters, in combination with information that identifies the consumer, and that may provide an indication whether the credit card transaction is fraudulent,

wherein each value among the plurality of parameters is weighted in the verifying step according to an importance, as determined by the merchant, of that value to the credit card transaction, so as to provide the merchant with a quantifiable indication of whether the credit card transaction is fraudulent;

¹ In its analysis, the court noted that the initial patent examiner rejected the claims at issue for failing to be “in the technological arts”; however, that examiner “apparently left the U.S. Patent Office, and the application was assigned to another patent examiner ... who ultimately allowed the claims...” *Id.* at 1055 (citation omitted). Although the notice of allowance did not mention patent eligibility issues, a summary of an examiner interview echoed the applicant’s assertion that the claims were eligible under the “useful, concrete, and tangible result” test. *Id.* (citation omitted). Thus, the court found that the examiner’s “decision to allow the claims relied in large part on the ‘useful, concrete, and tangible result’ test rejected by *Bilski*.” *Id.*



wherein execution of the program instructions by one or more processors of a computer system causes the one or more processors to carry out the further steps of;

obtaining information about other transactions that have utilized an Internet address that is identified with the credit card transaction; constructing a map of credit card numbers based upon the other transactions; and utilizing the map of credit card numbers to determine if the credit card transaction is valid.

* * *

3. A method for verifying the validity of a credit card transaction over the Internet comprising the steps of:

a) obtaining information about other transactions that have utilized an Internet address that is identified with the credit card

transaction;

b) constructing a map of credit card numbers based upon the other transactions; and

c) utilizing the map of credit card numbers to determine if the credit card transaction is valid.

Id. at 1071. Claim 3, *inter alia*, was a method performed “over the Internet” and, claim 2 was a *Beauregard*-type claim.² See *Id.* The court applied the *Bilski* machine-or-transformation test to both claims. See *Id.* at 1073-81 (“Like claim 3, claim 2 is subject to the machine-or-transformation test for patent eligibility.”).

For the method claim, the court explained in its “machine” inquiry that “[t]he *Bilski* court specifically left it to future cases to determine ‘whether or when recitation of a computer suffices to tie a process claim to a particular machine.’” *Id.* at 1076 (quoting *Bilski*, 545 F.3d at 962)

(emphasis added). The court found that performing the method “over the Internet” was not a tie to a particular machine because “the internet is an abstraction ... as [o]ne can touch a computer or a network cable, but one cannot touch ‘the internet.’” *Id.* at 1077 (citing *Ferguson*, 558 F.3d at 1366). The court enhanced its reasoning by explaining that, under *Bilski*, “the use of the internet does not impose meaningful limits on the scope of the claims.” *Id.* (citing *Bilski*, 545 F.3d at 961). Similarly, the court noted that otherwise unpatentable subject matter “does not become patentable by tossing in references to internet commerce.” *Id.*

In its “transformation” analysis of the method the claim, the court ruled that collecting data into a “map” (a data structure) was not an adequate “transformation” of an “article,” because an article is “any physical object or substance, or an electronic signal representative of any physical object or substance.” *Id.*

² *Beauregard*-type claims are typically drafted to include a computer readable storage medium containing program instructions, where execution of those instructions causes one or more processors to perform a method.

at 1073 (citing *Bilski*, 545 F.3d at 964). The court stated that a mere “manipulation” of data (manipulating credit card numbers to create a data structure) did not satisfy the threshold of a “transformation.” *Id.* Rely on *Bilski*, the court explained that even if the steps constituted a transformation, a credit card number is not – and does not represent – a physical object or substance. See *Id.* at 1074-75. The court further searched for a “visual depiction” as “required by the *Bilski*” opinion, but did not find such limitations in the claims. *Id.* at 1076 (citing *Bilski*, 545 F.3d at 963). Nonetheless, the court noted that “[e]ven if the ... process visually depicted a credit card, and even if this step otherwise met the transformation prong, it would have no utility.” *Id.* at 1076 n.7. Without resolving it, the court also framed “the legal question of whether the step purportedly meeting the transformation prong must, to do so, contribute to the claimed process’s usefulness.” *Id.*

For the *Beauregard*-type claim, the court also ruled it did not transform articles. *Id.* at 1080. Both the “over the Internet” and “one or more processors” limitations in the *Beauregard*-type claim were deemed to be inadequate ties to a particular machine. *Id.* at 1076-78. The court further noted that the specification failed to describe the processors or a computer. See *Id.* at 1076 (“the written description includes nary a detail about the ‘one or more processors’ recited by claim 2”).

In its analysis, the court explained that *In re Beauregard*, 53 F.3d 1583 (Fed. Cir. 1995), “was not a decision on the merits of patentability.” *Id.* at 1079. Moreover, *In re Alappat*, 33 F.3d 1526 (Fed. Cir. 1994), was “abrogated by *Bilski*” because it did not employ the machine-or-transformation test. *Id.* at 1080 (citing *Bilski*, 545 F.3d at 959).

The court found recent decisions of the BPAI persuasive: “Following *Bilski*, the Board has rightly held that simply appending ‘A computer readable media including program instructions...’ to an otherwise non-statutory process claim is insufficient to make it statutory.” *Id.* (quoting *Ex parte Cornea-Hasegan*, 89 U.S.P.Q.2d

The court enhanced its reasoning by explaining that, under *Bilski*, “the use of the internet does not impose meaningful limits on the scope of the claims.”

1557, 1561 (B.P.A.I. 2009)).

The court concluded its analysis with an interesting statement regarding so-called business method patents: “*Bilski*’s holding suggests a perilous future for most business method patents.... The closing bell may be ringing for business method patents, and their patentees may find they have become bagholders.” *Id.* at 1081.

5. *Versata Software, Inc. v. Sun Microsystems, Inc.*

The claims at issue in *Versata Software, Inc.* were “directed to a computer-based configuration system.” *Versata Software, Inc. v. Sun Microsystems, Inc.*, No. 2-06-CV-358 (TJW), Memorandum Opinion & Order, Dkt. No. 90, at p. 2 (E.D. Tex. Aug. 19, 2008). Representative independent claims at issue read as

follows:

1. A method of configuring a system in a computer system comprising the steps of:

defining a structural model hierarchy comprised of composite and container hierarchies and port relationships substructures;

instantiating in said computer system a configuration instance;

modifying said configuration instance in response to a request by creating in said configuration instance instances of one or more model elements based on said request;

storing said modifications in a list of modifications;

examining said instances to determine if a constraint exists;

satisfying in said computer said constraint when said constraint exists;

satisfying in said computer a component constraint of said component hierarchy when said instances are constrained by said component constraints;

satisfying in said computer container constraints of said container hierarchy when said instances are constrained by said container constraints;

satisfying in said computer connection constraints of said port relationship when said instances are constrained by said connection constraints;

committing said modifications to said configuration instance and removing said modifications from said modifications list when no constraint exists and when all constraints associated with said instances are satisfied; and

removing said modifications from said configuration instance and said modifications list when any constraint associated with said instances is not satisfied.

2. A method of configuring a system in a computer system comprising the steps of:

defining a structural model hierarchy comprised of composite and container hierarchies and port relationships substructures;

instantiating in said computer system a configuration instance;

(a) modifying said configuration instance in response to a request by creating in said configuration instance instances of one or more model elements based on said request;

(b) storing said modifications in a list of modifications;

(c) examining said instances to determine if a constraint exists;

(d) satisfying in said computer said constraint when said constraint exists;

(e) committing said modifications to said configuration instance and removing said modifications from said modifications list when no constraint exists and when said constraint is satisfied; and

(f) removing said modifications from said configuration instance and said modifications list when said constraint is not satisfied.

30. A configuration apparatus comprising:

a central processing unit (CPU);

a modeling system coupled to said CPU, said modeling system configured to define a

model having information about elements available for inclusion in a system configuration; and

a configurator coupled to said CPU, said configurator configured to select a plurality of said elements of said model for inclusion in said system configuration in response to configuration requests.

40. In a computer system, a method of generating a configuration for a system comprising the steps of:

defining an element model consisting of elements used to configure said system and structural relationships between said elements in said model;

creating a plurality of components of said system that are instances of one or more elements of



said model in response to configuration requests;

identifying one or more of said plurality of components that can satisfy constraints of said plurality of components; and

creating a second plurality of components to satisfy constraints if said constraints cannot be satisfied by said one or more of said plurality of components.

41. An article of manufacturing comprising:

a computer usable medium having computer readable program code embodied therein for generating a configuration for a system, said system configuration specifying a plurality of components that comprise said system comprising;

computer readable program code configured to cause a computer to define a model that includes a definition for each of a plurality of components selectable for inclusion in said system configuration and constraints on said plurality of components;

computer readable program code configured to cause a computer to receive a configuration request; computer readable program code configured to cause a computer to create an instance of a component in said system configuration in response to said configuration request; and

computer readable program code configured to cause a computer to satisfy a plurality of constraints of said component. U.S. Pats. Nos. 5, 515, 524; 5,708,798; 6,002,854.

The court in *Versata Software, Inc.* provided insight into its interpretation of *Bilski* in response to the accused

infringer's motion for judgment on the pleadings. See *Versata Software, Inc. v. Sun Microsystems, Inc.*, No. 2-06-CV-358 (TJW), 2009 WL 1084412, at *1 (E.D. Tex. March 31, 2009). The accused infringer contended that the *Bilski* decision invalidated the claims at issue. See *Id.* Specifically, that "the claimed methods do not satisfy the 'machine' portion of the test because they can be performed entirely within the human mind, or using pencil and paper." *Id.* And, "the claimed methods do not satisfy the 'transformation' portion of the test because they do not transform any article into a different state or thing."

The court rejected these arguments based on its "interpretation of *Bilski*" not being "so broad as" the accused infringer's. *Id.* The court explained that the Federal Circuit:

Decline[d] to adopt a broad exclusion over software or any other such category of subject matter beyond the exclusion of claims drawn to fundamental principles ... [and noted] the process claim at issue in the appeal is not, in any event, a software claim. Thus, the facts here would be largely unhelpful in illuminating the distinctions between those software claims that are patent-eligible and those that are not.

Id. (quoting *Bilski*, 545 F.3d at 959 n. 23 (internal citations omitted)).

Accordingly, the court denied the motion.

6. *Every Penny Counts, Inc. v. Bank of Am. Corp.*

The claim at issue in *Every Penny Counts, Inc.* was directed to "a system whereby consumers can save and/or donate a portion of a credit or debit transaction." Slip op. at 1. The claim read as follows:

A system, comprising:

a network;

entry means coupled to said network for entering into the network an amount being paid in a transaction by a payor;

identification entering means in said entry means and coupled to said network for entering an identification of the payor;

said network including computing means having data concerning the payor including an excess determinant established by the payor for the accounts;

said computing means in said network being responsive to said data and said identification entering means for determining an excess payment on the basis of the determinant established by the payor; and

said computing means in said network being responsive to the excess payment for apportioning, at least a part of the excess payment amount said accounts on the basis of the excess determined and established by the payor and on the basis of commands established by the payor and controlled by other than the payee. *Id.* at p.2.

The accused infringer in *Every Penny Counts, Inc.* moved for summary judgment of invalidity based on the Federal Circuit's *Bilski* decision. *Id.* at 2-3. Previously, the court construed "computing means" as "the bank or card issuing institution's central computer, with a keypad and display, that is programmed to carry out the algorithm disclosed in" the patent's figures. *Every Penny Counts, Inc. v. Bank of Am. Corp.*, No. 2:07-cv-042, Opinion & Order, Dkt. No. 174 (M.D. Fla. Sept. 29, 2008).

While the claim was drafted as a system claim with structural elements, the court applied *Bilski*'s machine-or-transformation test to analyze whether the claim was drawn to sufficient statutory subject matter. See *Every Penny Counts, Inc.* slip op. at 3-5. The court explained that "the 'system' described by the claim at issue 'has no substantial practical application except in connection with' computers, cash registers, and networks, but it is not comprised of those devices. The [patent at issue] is a process, not a machine." *Id.* at 4-5.

In its "machine" analysis, the court found that the alleged ties to machines were merely "insignificant extra-solution activity." *Id.* at 5 (quoting *Bilski*, 545 F.3d at 961-62). In particular, the claimed "process" includes "a mathematical algorithm [that] uses machines for data input and data output and to perform the required calculations." *Id.* But, "those machines do not ... impose any limit on the process itself." *Id.*

The patentee did not contend that claim at issue was transformative. See *Id.* As a result, the court held the claim at issue invalid under *Bilski*. See *Id.*

7. DealerTrack, Inc. v. Huber

The claims at issue in *DealerTrack, Inc.* were directed to "a computer aided method of managing a credit application." 657 F. Supp. 2d at 1152 (internal quotation omitted). The independent claim at issue read as follows:

I. A computer aided method of managing a credit application, the method comprising the steps of: receiving credit application data from a remote application entry and display device; selectively forwarding the credit application data to remote funding source terminal devices; forwarding

funding decision data from at least one of the remote funding source terminal devices to the remote application entry and display device; wherein the selectively forwarding the credit application data step further comprises: sending at least a portion of a credit application to more than one of said remote funding sources substantially at the same time; sending at least a portion of a credit application to more than one of said remote funding sources sequentially until a finding source returns a positive funding decision; sending at least a portion of a credit application to a first one of said remote funding sources, and then, after a predetermined time, sending to at least one other remote funding source, until one of the finding sources returns a positive funding decision or until all funding sources have been exhausted; or sending the credit application from a first remote funding source to a second remote finding source if the first funding source declines to approve the credit application. U.S. Pat. No. 7,181,427.

The accused infringer in *DealerTrack, Inc.* moved for summary judgment of invalidity of the claims at issue under *Bilski*. See *DealerTrack, Inc.*, 657 F. Supp. 2d at 1154 (citing *Bilski*,

In its "machine" analysis, the court found that the alleged ties to machines were merely "insignificant extra-solution activity."

545 F.3d at 943). The patentee argued each of the following structures established a tie to a particular machine under *Bilski*: (i) "remote application entry and display device" and (ii) "terminal device." *Id.* at 1155-56. Respectively, the court construed those terms as (i) "any device, e.g., personal computer or dumb terminal, remote from the central processor, for application entry and display"; and (ii) "any device, e.g., personal computer or dumb terminal, located at a logical or physical terminus of the system." *Id.* at 1156.

The court relied on *In re Alappat* for the notion that "a general purpose computer in effect becomes a special purpose computer once it is programmed to perform particular functions pursuant to instructions from program software." *Id.* at 1155 (quoting *In re Alappat*, 33 F.3d at 1545). Nevertheless, based on its analysis, in part, of *CyberSource, Inc.* and a string of BPAI cases, the court found that each of the structures construed above were not a "particular machine" pursuant to *Bilski*. *Id.* (citing *CyberSource, Inc.*, 620 F. Supp. 2d at 1077; *Ex parte Gutta*, No. 2008-3000 at 5-6, 2009 WL 112393 (BPAI Jan. 15, 2009); *Ex parte Nawathe*, No. 2007-3360, 2009 WL 327520, at *4 (BPAI Feb. 9, 2009); *Ex parte Cornea-Hasegan*, No. 2008-4742 at 9-10, 2009 WL 86725 (BPAI Jan. 13, 2009)). The court noted that the patent "does not specify precisely how the computer hardware and database are 'specially programmed,' and the claimed central processor is nothing more than a general purpose computer that has been programmed in some unspecified manner." *Id.*

The patentee conceded that the claims at issue were not transformative. See *Id.* at 1154. Accordingly, the court held the claims



at issue invalid under *Bilski*. See *Id.* at 1156.

8. Research Corp. Techs., Inc. v. Microsoft Corp.

The claims in *Research Corp. Techs., Inc.* “relate to image halftoning technology used in computers and printers.” 2009 WL 2413623, at *1. The representative claims at issue, as construed by the court, read as follows:

(1) A method for the **halftoning** [the simulation of a continuous tone image, such as a shaded drawing or photograph, with groups or cells of color or black dots. The dots are placed in such a way that they appear to the human eye to be a single color] of **gray scale images** [collection of numerical gray scale values, as stored in a computer, for the gray tone pixel measurements of an image] by utilizing a **pixel-by-pixel comparison** [a threshold operation in which a single pixel

gray scale value, derived from the continuous tone image, will be compared to a single pixel of a mask to determine whether a dot is turned on at the corresponding pixel location in the resultant halftone image] of the image against a **blue noise mask** [a halftone mask with wraparound properties that produces blue noise and visually pleasing dot profiles at any level of gray] in which the **blue noise mask** is comprised of a **random non-deterministic** [an entity, such as a quantity, event, or thing (e.g., a number, or a position of a dot) that is not predictable in outcome, i.e., there is no fixed or known or determinable rule that, by observation of the previous examples of the entity alone, allows the prediction of any future example of the entity], **non-white noise** [all of the power spectrum values are not approximately equal] **single valued function** [a halftone mask is a single value

function when every position of the mask has one and only one threshold value] which is **designed to produce** [acting with deliberated or explicit intent to create or deliver a desired outcome] **visually pleasing** [a dot profile is visually pleasing if it possesses the collection of properties that must include: (1) aperiodicity; (2) isotropy (low anisotropy); and (3) lack of lowfrequency graininess] **dot profiles** [the binary dot pattern resulting from performing a halftoning operation at a constant gray level] when **thresholded** [the result of comparing an operand against a fixed threshold and setting an operand less than the threshold to one value and an operand greater than or equal to the threshold to another value] at any level of said **gray scale images** [collection of numerical gray scale values, as stored in a computer, for the gray tone pixel measurements of an image].

(2) The method of claim 1, wherein said **blue noise mask** is used to halftone a **color image**.

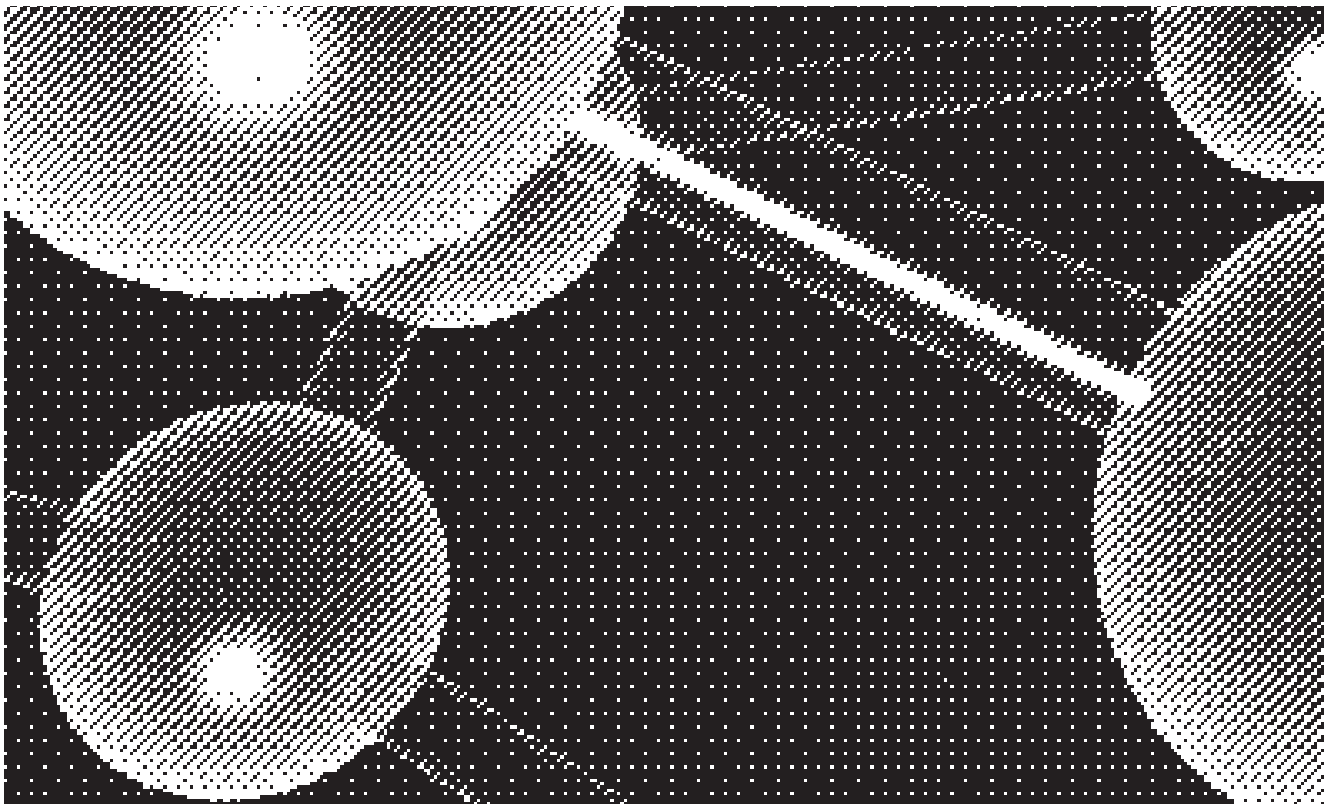
(11) A method for the **halftoning** [the simulation of a continuous tone image, such as a shaded drawing or photograph, with groups or cells of color or black dots. The dots are placed in such a way that they appear to the human eye to be a single color] of **color images** [an image that is formed and captured in more than one wavelength of light], comprising the steps of utilizing, in turn, a **pixel-by-pixel comparison** [a threshold operation in which a single pixel gray scale value, derived from the continuous tone image, will be compared to a single pixel of a mask to determine whether a dot is turned on at the corresponding pixel location in the resultant halftone image] of each of a plurality of **color planes** [the decomposition of a color image into separate primary color components, called planes, for each member of a set of primary colors]

of said **color image** against a **blue noise mask** [a halftone mask with wraparound properties that produces blue noise and visually pleasing dot profiles at any level of gray] in which the **blue noise mask** is comprised of a **random non-deterministic** [an entity, such as a quantity, event, or thing (e.g., a number, or a position of a dot) that is not predictable in outcome, i.e., there is no fixed or known or determinable rule that, by observation of the previous examples of the entity alone, allows the prediction of any future example of the entity], **non-white noise** [all of the power spectrum values are not approximately equal] **single valued function** [a halftone mask is a single value function when every position of the mask has one and only one threshold value] which is designed to provide **visually pleasing** [a dot profile is visually pleasing if it possesses the collection of properties that must include: (1) aperiodicity; (2)

isotropy (low anisotropy); and (3) lack of lowfrequency graininess] **dot profiles** [the binary dot pattern resulting from performing a halftoning operation at a constant gray level] when **thresholded** [the result of comparing an operand against a fixed threshold and setting an operand less than the threshold to one value and an operand greater than or equal to the threshold to another value] at any level of said **color images**, wherein a plurality of blue noise masks are separately utilized to perform said **pixel-by-pixel comparison** and in which at least one of said **blue noise masks** is **independent and uncorrelated** [dot profiles are generated by random processes that possess no statistical dependence and no statistical correlation] with the other **blue noise masks**.

* * *

(1) A method for the **halftoning** [the simulation of a continuous



tone image, such as a shaded drawing or photograph, with groups or cells of color or black dots. The dots are placed in such a way that they appear to the human eye to be a single color] of **color images** [an image that is formed and captured in more than one wavelength of light] which comprises the step of utilizing, in turn, a **pixel-by-pixel comparison** [a threshold operation in which a single pixel

...the claims at issue that merely “assembl[ed] ... gray scale images to generate final dot profiles” were not transformative because they did not “mandate a further visual display or image....”

gray scale value, derived from the continuous tone image, will be compared to a single pixel of a mask to determine whether a dot is turned on at the corresponding pixel location in the resultant halftone image] of each of a plurality of **color planes** [the decomposition of a color image into separate primary color components, called planes, for each member of a set of primary colors] of said color **image against a mask** [an ordering of a set of values in a regular format in a twodimensional structure of rows and columns that is used for halftoning an image by comparison of image pixels against corresponding mask pixels] in which the **mask** comprises a **non-determinate** [the meaning

is synonymous with unpredictable, or lacking the ability to be predicted] **non-white noise** [all of the power spectrum values are not approximately equal] **single valued function** [a halftone mask is a single value function when every position of the mask has one and only one threshold value] which is designed to provide visually pleasing [a dot profile is **visually pleasing** if it possesses the collection of properties that must include: (1) aperiodicity; (2) isotropy (low anisotropy); and (3) lack of lowfrequency graininess] **dot profiles** [the binary dot pattern resulting from performing a halftoning operation at a constant gray level] when **thresholded** [the result of comparing an operand against a fixed threshold and setting an operand less than the threshold to one value and an operand greater than or equal to the threshold to another value] and wherein said step of utilizing said **pixel-by-pixel comparison** is used to produce a **halftoned** image.

* * *

(11) A method for the **halftoning of color images** which comprises the step of utilizing, in turn, a **pixel-by-pixel comparison** of each of a plurality of **color planes** of said **color image** against a respective one of a plurality of **masks** in which each respective **mask** comprises a **non-deterministic, non-white noise single valued function** which is designed to provide **visually pleasing dot profiles** when **thresholded** and wherein said step of utilizing said **pixel-by-pixel comparison** is used to produce a **halftoned** image.

* * *

(2) A method for **halftoning** [the simulation of a continuous tone image, such as a shaded drawing or photograph, with groups or cells of color or black dots. The dots are placed in such a way that they appear to the human eye to be a single color] **image information** [any information obtained from a continuous tone image] which comprises the step of **comparing** [the function performed by a comparator: a device, (or collection of operations, as in software) that compares an input number (called the operand) to a number prestored in the comparator (called the threshold) and produces as output a binary value (such as “0,” zero) if the input is algebraically less than the threshold, and produces the opposite binary value (such as “1,” one) if the input is algebraically greater than or equal to the threshold] such information against at least one **array** [an ordering of a set of quantities, such as numbers, in a regular format, e.g., the ordering of numbers in a two-dimensional structure of rows and columns], wherein said at least one **array** is comprised of **multibit threshold values** [values used in threshold operations that possess multiple bits of significance], and said at least one **array**, when **thresholded** [the result of comparing an operand against a fixed threshold and setting an operand less than the threshold to one value and an operand greater than or equal to the threshold to another value], produces a dot pattern according to a substantially **blue noise power spectrum** [a power spectrum which has small or negligible low frequency in the low frequency region adjacent the ordinate of the frequency plot; a transition region

from the low frequency region; and a high frequency region which has an absence of strong or dominant spikes sensed as artifacts in the spatial domain] and wherein said step of **comparing** is used to produce a **halftoned** image.

(6) A method for **halftoning** of an image which **comprises the step of comparing information derived from said image** [any information obtained from a continuous tone image] against at least one **array**, wherein said at least one **array**, when **thresholded**, produces a pattern that exhibits a power spectrum substantially characteristic of a **blue noise power spectrum** and wherein said step of **comparing** is used to produce a **halftoned** image.

* * *

(29) Apparatus for the **halftoning** [the simulation of a continuous tone image, such as a shaded drawing or photograph, with groups or cells of color or black dots. The dots are placed in such a way that they appear to the human eye to be a single color] of **color images** [an image that is formed and captured in more than one wavelength of light] comprising a **comparator** [a device, (or collection of operations, as in software) that compares an input number (called the operand) to a number prestored in the comparator (called the threshold) and produces as output a binary value (such as "0," zero) if the input is algebraically less than the threshold, and produces the opposite binary value (such as "1," one) if the input is algebraically greater than or equal to the threshold] for **comparing** [the function performed by a comparator], on a **pixel-by-pixel basis** [a threshold operation

The court explained that the machine-or-transformation test is one "for determining whether a process claim is 'tailored narrowly enough to encompass only a particular application of a fundamental principle rather than to pre-empt the principle itself.'"

in which a single pixel gray scale value, derived from the continuous tone image, will be compared to a single pixel of a mask to determine whether a dot is turned on at the corresponding pixel location in the resultant halftone image], a plurality of **color planes** [the decomposition of a color image into separate primary color components, called planes, for each member of a set of primary colors] of said **color image** against a **blue noise mask** [a halftone mask with wraparound properties that produces blue noise and visually pleasing dot profiles at any level of gray] in which the **blue noise mask** is comprised of **random non-deterministic** [an entity, such as a quantity, event, or thing (e.g., a number, or a position of a dot) that is not predictable in outcome, i.e., there is no fixed or known or determinable rule that, by observation of the previous examples of the entity alone, allows the prediction of any future example of the entity], **non-white noise** [all of the power spectrum values are not approximately equal] **single valued function** [a halftone mask

is a single value function when every position of the mask has one and only one threshold value] which is designed to provide **visually pleasing** [a dot profile is visually pleasing if it possesses the collection of properties that must include: (1) aperiodicity; (2) isotropy (low anisotropy); and (3) lack of low-frequency graininess] **dot profiles** [the binary dot pattern resulting from performing a halftoning operation at a constant gray level] when **thresholded** [the result of comparing an operand against a fixed threshold and setting an operand less than the threshold to one value and an operand greater than or equal to the threshold to another value] at any level of said **color images**, wherein an output of said **comparator** is used to produce a **halftoned** image.

(42) An apparatus for **halftoning image information** [any information obtained from a continuous tone image], comprising a **comparator** for **comparing** such information against at least one **array** [an ordering of a set of quantities, such as numbers, in a regular format, e.g., the ordering of numbers in a two-dimensional structure of rows and columns], where said at least one array is comprised of **multibit threshold values** [values used in threshold operations that possess multiple bits of significance], and said at least one **array**, when **thresholded**, produces a dot pattern according to a substantially **blue noise power spectrum** [a power spectrum which has small or negligible low frequency in the low frequency region adjacent the ordinate of the frequency plot; a transition region from the low frequency region; and a high

frequency region which has an absence of strong or dominant spikes sensed as artifacts in the spatial domain] and wherein an output of said **comparator** is used to produce a **halftoned** image.

(72) An apparatus for **halftoning** a **color image**, comprising a **comparator** for **comparing** information derived from at least one component color of such image against at least one **array**, wherein said at least one **array**, when **thresholded**, exhibits a power spectrum substantially characteristic of a **blue noise power spectrum** and wherein an output of said **comparator** is used to produce a **halftoned** image. *Id.*, at *11-17 (emphasis in original).

The court explained that the machine-or-transformation test is one “for determining whether a process claim is ‘tailored narrowly enough to encompass only a particular application of a fundamental principle rather than to pre-empt the principle itself.’” *Id.*, at *6 (quoting *Bilski*, 545 F.3d at 954). It added that “[t]he machine-or-transformation test solves the issue of inappropriate preemption....” *Id.*, at *8 (citing *Bilski*, 545 F.3d at 957). The court noted that the machine-or-transformation test accomplishes this result, in part, based on “[t]wo corollaries”: (1) “post-solution and [(2)] field-in-use limitations are insufficient to make a claim to a fundamental principle process patent eligible.” *Id.* at *7. It cited prior precedent for what may constitute “postsolution activities:” “a simple recordation step in the middle of the claimed process”; and “a presolution step of gathering data....” *Id.* (citing *In re Schrader*, 22 F.3d 290, 294 (Fed. Cir. 1994); *In re Grams*, 888 F.2d 835, 839-40 (Fed. Cir. 1989)).

The court interpreted the Federal Circuit’s discussion of *In re Abele* in *Bilski* as providing two requirements for a claimed process to be transformative: “it should be (1) limited to transformation of specific data, and (2) limited to a visual depiction representing specific objects or substances.” *Id.*, at *9.

Based on its interpretation of *Bilski*, the court analyzed the representative claims at issue under the machine-or-transformation test. See *Id.*, at *11-17. It found that all the claims at issue failed the “machine” prong of the test, as the claims “state[d] no particular machine [that] is required for [the claimed] algorithm....” *Id.*, at *13. Notably, the court explained that its interpretation of “comparator”— “[a] device (or collection of operations, as in software)” — could include software per se and, therefore, a “comparator” was not a “particular” machine. *Id.*, at *17 (citation omitted). In other words, the court expressed that “the potential for use on a machine is not the equivalent of being tied to a machine.” *Id.* Moreover, “the term ‘device’ is not synonymous with machine.” *Id.*

In its transformation analysis, the court found that the claims at issue which recite “the production of an image as a result of the comparison numbers” are transformative. *Id.*, at *15. Specifically, “the comparison between the halftoned color images and each of the color planes against a mask which is designed to produce visually pleasing dot profiles to finally produce a halftoned image” or “the comparison of a halftoned image against an array, or an ordering of umbers, and that the array produces a pattern when it undergoes another comparison through thresholding, and that the step of comparing those numbers produces a halftones image” claim “a transformation of specific



data” that “is further limited to a visual depiction which represents specific objects.” *Id.* In addition, the court found that even the “recitation of the production of an image as a result of the comparison of numbers” rose to the level of performing a “transformation.” *Id.* However, the claims at issue that merely “assembl[ed] ... gray scale images to generate final dot profiles” were not transformative because they did not “mandate a further visual display or image....” *Id.*, at *10.

As a result, the court invalidated the claims under *Bilski* that were both not transformative and not tied to a particular machine. See *Id.*, at *18.

9. *Abstrax, Inc. v. Dell, Inc.*

The claims at issue in *Abstrax, Inc.* were “directed to a method for assembling a product having components wherein the variable portions of a set of abstract assembly steps are resolved in accordance with data from a desired

configuration.” *Abstrax, Inc. v. Dell, Inc.*, No. 2:07-CV- 221-DF-CE, 2009 WL 3255085, at *2 (E.D. Tex. Oct. 7, 2009). Representative claim 10 read as follows:

10. A method, performed by a computer, for assembling a product having components, the method comprising the steps of:

(a) providing one or more abstract assembly steps for assembling the product, the abstract assembly steps containing variable portions for assembling the product with potentially different configurations, the variable portions including variable parameters capable of representing different component information;

(b) obtaining a configuration model corresponding to a requested configuration of the product, the configuration model including one or more of the component information lines corresponding to one or more components utilized in the requested configuration; and

(c) applying the configuration model to the abstract assembly steps provided for assembling the product by inserting component information from the component information lines into the variable parameters of the variable portions of the abstract assembly steps to produce one or more assembly instructions for assembling the product to have the requested configuration. *Id.*, at *2-3.³

The court in *Abstrax, Inc.* reviewed the claim 10 under the *Bilski* machine-ortransformation test. *Id.*, at *2-4. In its transformation analysis, the court explained that the issue is “what sorts of things

In its transformation analysis, the court found that the claims at issue which recite “the production of an image as a result of the comparison numbers” are transformative.

constitute ‘articles’ such that their transformation is sufficient to impart patent-eligibility under §101.” *Id.*, at *3 (quoting *Bilski*, 545 F.3d at 962). Furthermore, the court noted that “today’s ‘articles’ are often electronic signals and electronically manipulated data...” *Id.*, at *3.

Rejecting the accused infringer’s argument that the data at issue was too broadly claimed, the court expressed that “[t]he rejected claim in *Abele* ‘did not specify any particular type of nature of data; nor did it specify how or from where the data was obtained or what the data represented.’” *Id.* (quoting *Bilski*, 545 F.3d at 962). The court held that the data in claim 10 “represents physical and tangible objects and their respective structures” because it concerns “how parts, pieces, or components of a product fit together and how they are configured.” *Id.* Additionally, “the claims indicate that the data is obtained from the component information lines in the configuration model.” *Id.*

The court also rejected the accused infringer’s argument that the claim did not contain a sufficient “visual depiction.” *Id.*, at *4. “Here, the raw data is transformed into assembly instructions for assembling the

product to have the requested configuration.” *Id.* Notably, the court mentioned that “transformation of ‘configuration model’ impose[d] meaningful limits on the claim’s scope” because both parties proposed the term “configuration model” for claim construction. *Id.* (“Ostensibly, a claim term that both parties feel warrants construction would impose limits on a claim and would not be merely extra-solution activity.”)

As a result, the court found the claims at issue satisfied *Bilski*. See *Id.*

10. Fuzzysharp Techs. Inc., 3D Labs Inc., Ltd.

The claims in *Fuzzysharp Techs. Inc.* were directed to “mathematical algorithms that can be used to reduce the number of calculations required to determine whether a 3D surface is visible or invisible on a display screen.” *Fuzzysharp Techs. Inc. v. 3D Labs Inc., Ltd.*, No. C 07-5948 SBA, 2009 WL 4899215, at *1 (N.D. Cal. Dec. 11, 2009). The representative claims at issue, as construed by the court, read as follows:

1. A method of reducing the visibility related computations in 3-D computer graphics, the visibility related computations being performed on 3-D surfaces or their sub-elements, or a selected set of both, the method comprising:

[a] identifying grid cells which are under or related to the projections or extents of projections associated with at least one of said 3-D surfaces or their sub-elements;

[b] comparing data associated with said at least one of 3-D surfaces or their sub-elements

³ The author notes the irony of a software patent holder both using the claim limitation “abstract” and having a tradename including “Abstrax”.

with stored data associated with the grid cells;

[c] *determining which of said at least one of 3-D surfaces or their subelements is always invisible or always visible* to a viewpoint or a group of viewpoints by projection based computations prior to a visibility computations; and

[d] *ignoring* said determined at least one of the 3-D surfaces or their subelements during said visibility computation.

12. A method of reducing a step of visibility computations in 3-D computer graphics from a perspective of a viewpoint, the method comprising:

[a] computing, before said step and from said perspective, the visibility of at least one entity selected from 3-D surfaces and sub-elements of said 3-D surfaces, wherein said computing step comprises:

[i] *employing* at least one projection plane for generating projections with said selected set of 3-D surfaces and said sub-elements with respect to said perspective;

[ii] *identifying* regions on said at least one projection plane, wherein said regions are related to the projections associated with said selected 3-D surfaces, said sub-elements, or bounding volumes of said 3-D surfaces or said subelements;

[iii] *updating* data related to said regions in computer storage; and

[b] *deriving* the visibility of at least one of said 3-D surfaces or said subelements from the stored data in said computer storage; and skipping, at said step of

visibility computations, at least an occlusion relationship calculation for at least one entity that has been determined to be invisible in said computing step.

1. A method of reducing the complexity of visibility calculations required for the production of multi-dimensional computer generated images, said method performed on a computer, said method comprising the steps of: prior to an occlusion or invisibility relationship computation (known per se) being carried out on a plurality of surfaces from each viewpoint to be calculated: for selected ones of said surfaces, determining for said viewpoint whether each said selected surface is:

(a) an always unoccluded surface, an always hidden surface, or a remaining surface; or

(b) an always unoccluded surface, or a remaining surface; or

(c) an always hidden surface, or a remaining surface; wherein said remaining surface is a

surface which is unable to be determined with certainty as to whether it is either unoccluded or hidden; exempting from said occlusion or invisibility relationship computation those surfaces which are either always unoccluded or always hidden; maintaining a record of said remaining surface; and carrying out occlusion or invisibility relationship computations on said remaining surfaces.

4. A method as claimed in Claim 1, wherein said images are selected from a group consisting of graphic images, computer vision data, abstract data and physical data.

5. A method as claimed in Claim 1, wherein the reduction in complexity involves a reduction in the number and/or visibility of visibility calculations. *Id.*, at *1-2.

The court in *Fuzzysarp Techs. Inc.* analyzed the claims at issue under the *Bilski* machine-or-transformation test. See *Id.*, at *2-5. The main issue was whether the claims at issue were tied to a “particular” machine.





Id., at *4. The patentee argued that the limitations, “computations” and “computer storage,” and constructions that referenced “using a data structure in a computer” and “projecting 3D images ‘on a computer screen’” established a sufficient tie to a particular machine. *Id.* The court rejected this argument noting “[t]he salient question is not whether the claims are tied to a computer,” but “[r]ather, as *Bilski* makes clear, the question is whether the claims are ‘tied to a particular machine.’” *Id.* (quoting *Bilski*, 545 F.3d at 961) (emphasis in original). The court stated “the claims are not tied to a particular computer, but simply make a generally [sic] reference to ‘a’ computer. Courts applying *Bilski* have concluded that the mere recitation of ‘computer’ or reference to using a computer in a patent claim is [sic] insufficient to tie a patent claim to a particular machine.” *Id.* The court found *DealerTrack, Inc.*, *CyberSource*, and three BPAI cases persuasive for this notion. See *Id.*, at *4-5 (citing *DealerTrack, Inc.*, 2009 WL 2020761, at *3; *CyberSource*, 620 F. Supp. 2d at 1077; *Ex Parte David Myr*, 2009

WL 3006497, at *8-9 (BPAI Sept. 18, 2009); *Ex Parte Nick M. Mitchell and Gary S. Sevitsky*, 2009 WL 460662, at *6 (BPAI Feb. 23, 2009); *Ex Parte Sandeep Nawathe and Vaishali Angal*, 2009 WL 327520, at *4 (BPAI Feb. 9, 2009)) (“Though the calculations may be ‘performed on a computer,’ they are not tied to any particular computer.”)⁴

As a result, the court found the claims at issue invalid under *Bilski*. See *Id.*, at *5.

II. Accenture Global Servs. GmbH v. Guidewire Software Inc.

The claims at issue in *Accenture Global Servs. GmbH* were directed to “a computer program for developing component based software for the insurance industry. The program includes a data component, a client component, and a controller component. The client component is responsible for allowing users to edit tasks, add new tasks, and ‘achieve an insurance-related goal upon completion,’ as well as to generate a historical record of completed tasks.” *Accenture Global Servs. GmbH v. Guidewire Software Inc.*, – F. Supp. 2d –,

2010 WL 771595, at *2 (D. Del. 2010). The claims at issue read as follows:

I. A system for generating tasks to be performed in an insurance organization, the system comprising: an insurance transaction database for storing information related to an insurance transaction, the insurance transaction database comprising a claim folder containing the information related to the insurance transaction decomposed into a plurality of levels from the group comprising a policy level, a claim level, a participant level and a line level, wherein the plurality of levels reflects a policy, the information related to the insurance transaction, claimants and an insured person in a structured format; a task library database for storing rules for determining tasks to be completed upon an occurrence of an event; a client component in communication with the insurance transaction database configured for providing information relating to the

⁴ The patentee conceded that the claims were not transformative. See *Id.*, at *4.

insurance transaction, said client component enabling access by an assigned claim handler to a plurality of tasks that achieve an insurance related goal upon completion; and a server component in communication with the client component, the transaction database and the task library database, the server component including an event processor, a task engine and a task assistant; wherein the event processor is triggered by application events associated with a change in the information, and sends an event trigger to the task engine; wherein in response to the event trigger, the task engine identifies rules in the task library database associated with the event and applies the information to the identified rules to determine the tasks to be completed, and populates on a task assistant the determined tasks to be completed, wherein the task assistant transmits the determined tasks to the client component.

8. An automated method for generating tasks to be performed in an insurance organization, the method comprising: transmitting information related to an insurance transaction; determining characteristics of the information related to the insurance transaction; applying the characteristics of the information related to the insurance transaction to rules to determine a task to be completed, wherein an event processor interacts with an insurance transaction database containing information related to an insurance transaction decomposed into a plurality of levels from the group comprising a policy level, a claim level, a participant level and a line

level, wherein the plurality of levels reflects a policy, the information related to the insurance transaction, claimants and an insured person in a structured format; transmitting the determined task to a task assistant accessible by an assigned claim handler, wherein said client component displays the determined task; allowing an authorized user to edit and perform the determined task and to update the information related to the insurance transaction in accordance with the determined task; storing the updated information related to the insurance transaction; and generating a historical record of the completed task.

* * *

I. A method for generating a file note for an insurance claim, comprising the steps of, executed in a data processing system, of: prefilling a first set of fields with information identifying

a file note, said information comprising at least one suffix indicating a type of insurance coverage for a participant in a claim and identification of the participant, wherein the at least one suffix is preselected from one or more types of insurance coverage applicable to the claim; obtaining a selection of fields of a first set of fields from a user, the selection identifying information for a second set of fields; displaying in the second set of fields, the information identified by selection of field of the first set of fields; permitting the user to add data to a predefined text area related to each field of the second set of fields based on the selected fields; generating a file note that contains the first set of fields, the second set of fields, and the data in the predefined text area; identifying a level of significance of the file note; and storing the file note with the identified level of significance in a claim database including file notes associated with the claim.

9. A method for generating a file note for an insurance claim folder, comprising: providing on a display device a claim folder screen depicting attributes associated with a claim, the attributes comprising at least one suffix indicating a type of insurance coverage for a participant in the claim; permitting the selection of at least one attribute associated with a claim on the claim folder screen; providing on a display device a file note screen depicting the selected at least one attribute in a criteria section, and a text entry section, wherein the text entry section is based on the selected at least one attribute in the criteria section; receiving from a user information

The patentee argued that the limitations, “computations” and “computer storage,” and constructions that referenced “using a data structure in a computer” and “projecting 3D images ‘on a computer screen’” established a sufficient tie to a particular machine.

associated with the text entry section; generating the file note based on information received from the user; identifying a level of significance of the file note according to information received from the user; and storing the file note with the identified level of significance in a searchable claim database, the claim database associating the file note being with a file note index indicating changes to the file note.

* * *

13. A system for generating a file note for an insurance claim, comprising: prefilling means for prefilling a first set of fields with information identifying a file note, said information comprising at least one suffix indicating a type of insurance coverage for a participant in a claim and identification of the participant, wherein the at least one suffix is preselected from one or more types of insurance coverage applicable to the claim; obtaining means for obtaining a selection of fields of a first set of fields from a user, the selection identifying information for a second set of fields; displaying means for displaying in the second set of fields, the information identified by selection of field of the first set of fields; permitting means for permitting the user to add data to a predefined text area related to each field of the second set of fields based on the selected fields; generating means for generating a file note that contains the first set of fields, the second set of fields, and the data in the predefined text area; and identifying means for identifying a level of significance of the file note; and storing means for storing the file note with the identified level of significance in

a claim database including file notes associated with the claim.
Id.

While the court in *Accenture Global Servs. GmbH* stayed trial “until such time as a decision is issued in *Bilski v. Doll*,” it issued an opinion one week later to “briefly illuminate [] several of its concerns regarding the patentability of the [claims at issue] under the *Bilski* framework.” *Accenture Global Servs. GmbH v. Guidewire Software Inc.*, No. 07-826-SLR, 2010 WL 723003, at *1 (D. Del. Feb. 26, 2010); *Id.*

In its transformation analysis, the court found that the claims manipulated “non-tangible information” such as “the cost of automobile repair, hours worked, or the amount of medical expenses.” *Id.*, at *16. Accordingly, “even if a tangle visual ‘display’ [was] provided, that visual image would not represent any specific tangible objects (or type of data).” *Id.*

In its machine analysis, the court explained that limitations such as “claim database,” “a display device,” “a file note screen,” a “searchable claim database,” and “a claim folder,” while construed “as computer-related,” “do not imply a specific computer having any particular programming – they are descriptive of a general computer system at best.” *Id.*, at *17. Moreover, the claim term – “a data processing system comprising a memory, secondary storage device, central processing unit, input device and video display; the memory contains a program for automatically generating file notes” – also does not rise to the specificity of a particular machine. See *Id. Relying on Every Penny Counts, Inc. and Research Corp. Tech., Inc.*, the court expressed that “[i]f the architecture of the computer is of no import, it is unclear how the claimed methods are drawn to a specific

machine within the meaning of *Bilski*.” *Id.* (citing *Every Penny Counts, Inc.*, 2009 U.S. Dist. LEXIS 53626, at *6; *Research Corp. Tech., Inc.*, 2009 WL 2413623 at *17) In other words, “the patent claims implicate the use of a machine, but a machine does not impose any limit on the claimed methods themselves.” *Id.* Nonetheless, the court conceded that “[i]t is unclear to the court whether (and how) the claims maybe interpreted to define a particularly-programmed computer.” *Id.*, at *17.

The court held that although “it is not self evidence that the patents are drawn to tangible inventions rather than to concepts, ... [t]he court may revisit the issue upon defendant’s renewed motion should the Supreme court validate the *Bilski* framework.” *Id.* at *19.

IV. Conclusion

Almost three decades have passed since the Supreme court has substantively ruled on patent eligibility. District courts have balanced the costs of adjudicating outstanding material issues against the benefits of waiting for further clarification of the Federal Circuit’s *Bilski* holding from the Supreme court. The district courts that felt compelled to rule on patent eligibility issues have had to fill in the gaps of the Federal Circuit’s *Bilski* decision as necessary to rule on the cases before them. During this process, the law of patent eligibility for software and business methods has become refined in some instances and redefined in others. Patent practitioners, investors, intellectual property asset managers, and business decision-makers alike all anxiously await the Supreme court’s opinion to see if such refining or redefining controls.

A photograph of several wind turbines in a field, overlaid with a semi-transparent green filter. The turbines are silhouetted against a lighter background, and their blades are spread out in various directions. The overall color palette is dominated by shades of green.

CLEAN ENERGY



ITC patent dispute over wind turbines turns political

By
Lawrence T. Kass

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The case developed into a battleground of public policy, with members of Congress weighing in.

It's not easy being green. The clean-technology revolution presents new challenges and opportunities somewhat unique to green energy innovation, project development and finance. Clean-tech companies, financiers and their counsel must understand and appreciate more than ever how to navigate and even avail themselves of the interplay among public policy, politics and intellectual property. The patent litigation between General Electric Co. and Mitsubishi Heavy Industries Ltd. at the U.S. International Trade Commission (ITC) over certain wind turbines is a case in point. The case concluded on Jan. 8, when the full commission issued a final determination of no violation by Mitsubishi.

During the past several months, the case developed into a battleground of public policy and politics, with various senators and representatives weighing in for one side or the other. Already a closely watched case due to its

high stakes for the renewable energy sector, the added political overtones and scrutiny increased the need to quickly appreciate and address sensitive economic and political issues when litigating cleanenergy patents.

The ITC began an investigation in March 2008 based on GE's complaint that Mitsubishi was importing and selling wind turbines that allegedly infringe three GE patents. On Aug. 7, 2009, an ITC administrative law judge (ALJ) issued an initial determination that, for some (not all) asserted claims in two of three GE patents, Mitsubishi was infringing and violating §337 of the Tariff Act of 1930 by importing and selling its accused turbines and components. Facing possible exclusion of its turbines from the U.S. market, Mitsubishi petitioned the full commission to review the ALJ's adverse initial determinations.

An investigative staff attorney from the ITC's Office of Unfair Import Investigations also weighed in with a petition for review, disagreeing with some of the ALJ's determinations. The staff attorney questioned the infringement findings on certain patent claims and expressed concern about whether GE itself practices other claims in the U.S. wind turbine market, thereby satisfying a "domestic industry" requirement for a §337 violation. On the other hand, the staff attorney said, the

public interest should not preclude an exclusion order if Mitsubishi loses, even though Mitsubishi plans to open a \$100 million manufacturing plant in Arkansas for wind turbines. However, the staff attorney argued that, if Mitsubishi did lose, it nevertheless should be allowed to supply turbines to one wind farm project in Texas that received \$114 million in federal stimulus money.

In view of the petitions, the full commission announced on Oct. 8, 2009 that it would review the ALJ's initial determination. As part of the order for review, the commission noted that, if it were to contemplate some form of remedy against Mitsubishi, it would have to consider the remedy's effect upon the public interest. The notice explained that a violation could mean excluding the accused turbines from the United States and/or requiring Mitsubishi to cease and desist from their importation and sale. The commission invited public submissions to address, among other things, any potential remedy as well as its effect on the public. Written submissions by the parties and public were due on Nov. 2, with replies due on Nov. 9. The commission twice extended its own deadlines, finally announcing that it would render a determination by Jan. 8.

The considerable economic, political and public interest in the outcome of the case is undeniable. The U.S. market for wind turbines is expected to reach \$60.9 billion by 2013. GE is the largest U.S. manufacturer and supplier to that market. Mitsubishi is one of the largest importers, and it continued to take on large U.S. orders while seeking investment in projects for its wind turbines despite the ALJ's initial determination. Jessica Dye, "ITC Extends Mitsubishi Wind Turbine Investigation," Law 360,

Nov. 20, 2009. The market and the need for turbines is only expected to increase; indeed, the Obama administration has set a goal of generating 20% of U.S. electricity through wind energy by 2030.

It may be fairly questioned how much the input from politicians influenced the ITC's determination.

Politicians On Both Sides

With renewable energy being such a hot political and public policy issue, a number of politicians submitted letters to the commission. The letters tended to favor the company that maintains a major presence in the politician's respective state or district. Senators, representatives and the governor of Arkansas came out in force for Mitsubishi. They sent no fewer than seven letters, many including co-signatures of congressional colleagues outside Arkansas. Most met the commission deadlines of Nov. 2 or 9.

For example, Sen. Blanche Lincoln (D-Ark.) wrote a letter on Oct. 2, along with Sen. Ron Wyden (D-Ore.), urging the commission to look closely at the initial determination's "significant public policy implications." They argued that the ALJ's infringement determination was contrary to the staff attorney's views. On Nov. 9, Lincoln wrote a follow-up letter with Sen. Mark Pryor (D-Ark.) commending the ITC for ordering the full commission review. They emphasized a potential shortfall of

capacity as the industry endeavors to meet the Obama administration's wind generation goal for 2030.

Other politicians also wrote letters tending to favor GE. They largely represent states such as South Carolina, home to a large GE facility for manufacturing wind turbines; Georgia, home to GE Energy; and New York, the global headquarters for GE Wind's business.

The first was a Dec. 8 letter from Rep. Bob Inglis (R-S.C.), followed on Dec. 23 by Sen. Lindsey Graham (R-S.C.). Graham argued that the case is vitally important to the nation's ability to attract investment in clean energy. He explained that attracting companies like GE to invest in clean-energy research and development, engineering, testing, manufacturing, servicing and installation skills, requires strong protection of intellectual property.

Sens. Saxby Chambliss (R-Ga.) and Johnny Isakson (R-Ga.) wrote a brief letter on Dec. 23, pointedly suggesting that the dispute "may have become politicized" and urging the commission to decide the case on its merits. Sen. Charles Schumer (D-N.Y.), Sen. Kirsten Gillibrand (D-N.Y.) and Rep. Paul Tonko (D-N.Y.) wrote on Jan. 6 that weakening IP relating to clean technology poses a substantial risk of inhibiting "creation of new green jobs and the transition to a green economy."

The six letters for GE seemed somewhat belated, however. None of them met the commission's Nov. 2 and 9 deadlines. The earliest was dated Dec. 8, three were dated Dec. 23, one was dated Jan. 5 and one was dated Jan. 6—just two days before the commission's final determination target date of Jan. 8.



Policy, Politics And IP

The commission issued a largely procedural three-page notice on Jan. 8, simply stating that it had decided to terminate the investigation with a final determination of no violation and that an opinion would issue shortly. This took many by surprise.

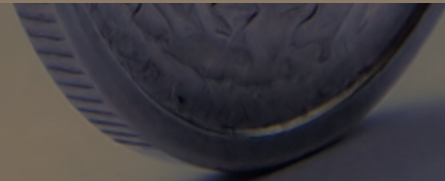
It may be fairly questioned how much the input from politicians actually influenced the commission's determination. Arguably, the public interest should affect only the remedy upon finding a violation and should have no bearing if the commission determines there was no violation. Yet the letters also clearly urged the

commission to conduct a particularly careful review of the merits. To the extent they did have any effect, one may question whether the belated input from the politicians for GE was too little, too late.

Although not all situations will present the same high stakes and draw the same level of attention, the GE/ Mitsubishi litigation illustrates that the interplay among public policy, politics and intellectual property can be particularly important in clean-energy cases. This interplay is not limited to ITC litigation because, for example, district courts also consider the public interest when evaluating whether to issue an injunction. Appreciation for this interplay, as well as a diverse legal

team possessing not only litigation capacity, but also broad experience and insight into the economics and public policies of renewable energy, can be a valuable asset.

For example, project finance counsel in this sector have valuable insight into the underlying market economics, including significant data, trends, dynamics, policies and players relating to investments in clean energy throughout the country. The ability to perceive opportunities for public interest support in a litigation and to quickly, effectively mobilize stakeholders may be aided by such capacities.



BANKRUPTCY



International Trade Commission Intellectual Property Investigations: An Exception to the Bankruptcy Code's Automatic Stay?

By
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Attorneys James R. Klaiber and Bradley S. Friedman of Milbank, Tweed, Hadley & McCloy LLP, New York, review two recent cases testing whether the intellectual property infringement lawsuits in the International Trade Commission are exempt from the automatic stay provisions of the Bankruptcy Code.

I. Introduction

In two recent cases, *In re Qimonda* and *In re Spansion*, bankruptcy courts were asked to determine whether International Trade Commission (“ITC”) investigations, a regulatory enforcement action often strategically and contemporaneously brought with a private intellectual property infringement suit, are exempted from the automatic stay provisions of

the U.S. Bankruptcy Code. In both cases, the bankruptcy courts held that the automatic stay did apply to ITC investigations involving the importation of goods that allegedly infringed on otherwise valid U.S. patents. However, on appeal, each of the respective district courts overturned those holdings, one on the merits and the other as moot.

These decisions, and the arguments of the parties, provide insight into how to strategically prepare or continue patent-related litigation when confronted with defendants that file for bankruptcy protection in the United States.

II. The Bankruptcy Code's Automatic Stay

Perhaps the most prominent protection provided to a debtor in a bankruptcy case is what is commonly known as the automatic stay. Section 362 of the Bankruptcy Code provides that upon the filing of a bankruptcy petition—the document that a debtor files to initiate a bankruptcy case—the debtor's estate and the debtor are automatically protected from, among other things, the commencement or continuation of suits on prepetition claims and from lien enforcement.¹ In particular, the actions that are subject to the automatic stay include, among other things: (a) a judicial or administrative action or proceeding

¹ See 11 U.S.C. §362(a).

against the debtor that was or could have been commenced before the filing for bankruptcy; (b) the enforcement, against the debtor or against the property of the debtor's estate, of a judgment obtained before the filing for bankruptcy; (c) any act to obtain possession of property of the estate or to exercise control over the property of the estate; and (d) any act to create, perfect, or enforce a lien against property of the debtor's estate.²

While the list of acts subject to the automatic stay is broad, the Bankruptcy Code expressly provides exceptions to and safe harbors from the automatic stay.³ One of the enumerated exemptions relates to proceedings by a "governmental unit" to enforce its "police and regulatory power."⁴ Under this "Police Powers Exception" a governmental unit may pursue certain actions against the debtor or the estate, but it may not enforce a money judgment or seize or seek control over property of the estate without first obtaining relief from the stay.⁵

In determining whether an action is covered by the Police Powers Exception, courts have developed two tests: (a) the pecuniary purpose test, which asks whether the governmental unit is pursuing a matter of public safety and welfare as opposed to a governmental pecuniary interest; and (b) the public policy test, which asks whether the government action is designed to effectuate a public policy rather than to adjudicate private rights.⁶

In particular, the ITC argued that although LSI, a private complainant, brought its allegations to the attention of the ITC, a formal Section 337 investigation can only be instituted by the ITC, a governmental unit, by a vote of the commissioners.

III. The ITC and Section 337 Actions

The ITC is an independent federal agency having broad investigative powers in matters of international trade. The ITC routinely conducts investigations of the impact of unfair trade practices, including subsidies, dumping, and the infringement of intellectual property rights, on U.S. commerce.

The ITC was originally formed in the early 20th century to police U.S. customs tariffs, but the Tariff Act of 1930 empowered the ITC to issue exclusion orders barring the importation of goods that violate the patent, copyright, or trademark rights of a U.S. entity having a domestic industry. An exclusion order is similar to an injunction against importation,

but empowers the U.S. Customs personnel to stop the infringing goods from crossing U.S. borders.

Typically, an ITC investigation of IP infringement brought under Section 337 of the Tariff Act is instituted based on a complaint filed by the holder of such rights. The statute requires that an investigation should be completed at the "earliest practical time,"⁷ which usually means within 12 to 18 months after its institution. The ITC has recently become an increasingly popular forum for U.S.-based entities (and others with a significant U.S. presence) to enforce their IP rights against the manufacturers and importers of infringing goods, given the backlog of cases in many U.S. district courts.⁸

IV. *In re Qimonda*

A. Background

On April 18, 2008, LSI Corp., owner of U.S. Patent No. 5,227,335, filed a complaint with the ITC alleging that certain named respondents had imported into the United States infringing semiconductor integrated circuits using tungsten metallization in violation of Section 337 of the Tariff Act of 1930. Following a preliminary investigation, the ITC ordered a formal investigation of LSI's complaint on May 14, 2008. Thereafter, Qimonda AG ("Qimonda") was named as an additional respondent.

² *Id.* The listed actions that are subject to the automatic stay are as follows: the commencement of a claim that arose or could have been brought against the debtor before the filing of the bankruptcy petition ((a)(1)); enforcement of a judgment (against the debtor or the estate's property) issued before the petition ((a)(2)); acts to "obtain possession" of property of the estate, or to "exercise control" over such property ((a)(3)); acts to create, perfect, or enforce liens against such property ((a)(4)); acts to create, perfect, or enforce liens against the debtor's property to secure claims arising before the petition ((a)(5)); acts to recover a claim against the debtor arising before the petition ((a)(6)); setoff of debt owing to the debtor arising before the petition ((a)(7)); and proceedings before the U.S. Tax Court concerning either a corporate or individual debtor's tax liability ((a)(7)).

³ See generally 11 U.S.C. §362(b); *Id.* at §§553, 555-557, 559-561.

⁴ 11 U.S.C. §362(b)(3).

⁵ Collier on Bankruptcy 362.05[5][a].

⁶ *Berg v. Good Samaritan Hospital Inc. (In re Berg)*, 230 F.3d 1165 (9th Cir. 2000).

⁷ 19 U.S.C. §1337(b)(1).

⁸ The average number of Section 337 investigations in calendar years 2000-2004 was 21, compared to an average of 34 for 2005-2009. As of November 2010, there were already 52 investigations instituted. See http://www.usitc.gov/intellectual_property/documents/cy_337_institutions.pdf (retrieved Nov. 23, 2010); http://www.usitc.gov/press_room/337_stats.htm (retrieved Nov. 23, 2010).



On June 15, 2009, Qimonda filed a petition for recognition of its pending German insolvency proceeding under Chapter 15 of the Bankruptcy Code.⁹ The U.S. Bankruptcy Court for the Eastern District of Virginia entered an order granting Qimonda's petition on July 22, 2009 (the "Recognition Order"), at which time the Chapter 15 filing automatically stayed under Section 362(a) of the Bankruptcy Code all pending U.S. litigation, including the ITC investigation against Qimonda.¹⁰

On July 13, 2009, LSI filed a notice of appeal of the court's order granting Qimonda's Chapter 15 petition. In mid-July, both LSI and the ITC also filed an objection to entry of the Recognition Order. On Feb. 16, 2010, the bankruptcy court rejected the ITC's argument that a Section 337 investigation is exempt from an automatic stay, holding that the police and regulatory exception under

Section 362(b)(4) of the Bankruptcy Code was inapplicable to an ITC investigation.

Rather, the bankruptcy court held that no exceptions to the automatic stay applied because (i) LSI, and not the ITC, controlled the litigation, and (ii) the remedy sought in the ITC proceeding—preventing infringing articles from being imported in the United States—was not a sufficient public policy under the police or regulatory power exception.

The ITC filed a timely notice of appeal on Feb. 26, 2010.¹¹ Meanwhile, the ITC issued a final determination in March 26, 2010, finding that the '335 patent was invalid for obviousness.¹²

B. The ITC's Arguments

On appeal to the U.S. District Court for the Eastern District of Virginia, the ITC contended that a Section 337

proceeding qualifies as an exercise of "police and regulatory authority," and therefore, it is exempt from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. The ITC provided a broad overview of the statutory background to the Section 362(b)(4) exception and concluded that a Section 337 investigation is both (i) conducted by a governmental unit, and (ii) promotes an important public interest.

In particular, the ITC argued that although LSI, a private complainant, brought its allegations to the attention of the ITC, a formal Section 337 investigation can only be instituted by the ITC, a governmental unit, by a vote of the commissioners. Further, the ITC contended that a Section 337 investigation advances the important public interest of protecting U.S. industries from imports that infringe valid U.S. patents, which is

⁹ For a brief overview of Chapter 15 and Qimonda's case see Blake Reese and Bradley S. Friedman, *Back to the Future (Lubrizol): Qimonda Bankruptcy Provides Debtors With a Windfall at the Expense of Their IP Licensees* (22 BBLR 316, 3/4/10), and *Back to the Future (Lubrizol) Part II: An Update on the Qimonda Bankruptcy* (22 BBLR 1101, 8/12/10).

¹⁰ No. 09-14766-RGM, 2009 WL 2210771 (Bankr. E.D. Va. July 16, 2009), *rev'd*, *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).

¹¹ LSI was not a party to the ITC's appeal.

¹² See *In the Matter of Certain Semiconductor Integrated Circuits by Using Tungsten Metallization*, Inv. No. 337-TA-648, 73 Fed. Reg. 29534 (May 21, 2008). It thus appears that the ITC proceeded with its investigation without giving any effect to the bankruptcy court's order enforcing the automatic stay.

independent of, and in addition to, any private rights afforded to patent holders.

C. Qimonda's Arguments

Qimonda argued that in light of the '335 patent's then-forthcoming expiration in July 2010, and the current liquidation of Qimonda's estate, the ITC's appeal would soon be moot and the appellate court should decline to consider it. In the alternative, Qimonda relied on and incorporated all arguments from its reply brief before the bankruptcy court, which argued that the automatic stay applied because LSI initiated the ITC investigation, the Section 337 proceeding was brought by a private individual rather than a governmental unit and benefited a single party rather than the general public.

D. Virginia District Court Decision

On June 28, 2010, Judge T.S. Ellis of the U.S. District Court for the Eastern District of Virginia issued an order overturning the bankruptcy court's decision.¹³ In reviewing the novel question of whether Section 362(b)(4) of the Bankruptcy Code operates to except a Section 337 proceeding from an automatic stay, the court determined that the bankruptcy court had erred in applying the automatic stay to the ITC's investigation because the ITC proceeding was an action brought by a governmental unit to enforce its police and regulatory power.

After providing a detailed synopsis of the statutory framework governing Section 337, Ellis determined that (i) the ITC is a federal agency created by Congress, and therefore qualifies as a governmental unit; (ii) the formal ITC investigation commenced only

Highlighting certain Third Circuit precedent, Samsung and the ITC argued that the bankruptcy court should apply the pecuniary purpose/public policy test for determining whether the exception applies.

after the ITC determined that the LSI complaint warranted an investigation, and LSI's filing of the complaint did not transform the ITC investigation into an action by a private party; and (iii) the ITC's investigation vindicates a public interest because the ITC has no pecuniary interest in Qimonda's estate and the statutes and regulations governing a Section 337 investigation require the ITC and the president, in consultation with other agencies, to consider the effect an ITC determination will have on the public health, welfare, and competition.

V. In re Spansion

A. Background

In November 2008, Spansion, Inc. ("Spansion") initiated parallel patent infringement actions in a federal district court and with the ITC against Samsung Electronics Co. ("Samsung") Shortly thereafter, on Jan. 16, 2009, Samsung asserted patent infringement counterclaims against Spansion in the district court action.

Although Spansion later filed voluntary Chapter 11 and Chapter 15 petitions on March 1, 2009 and April 30, 2009, respectively, with the U.S. Bankruptcy Court for the District of Delaware, a bankruptcy court-approved stipulation modified the automatic stay, permitting Samsung to proceed with its pre-petition counterclaims. Despite the stipulation, Samsung withdrew its district court counterclaims and instead filed a new postpetition ITC action against Spansion for patent infringement on July 31, 2009.

Upon the filing of motions by various Spansion noteholders, on Oct. 1, 2009, the bankruptcy court issued orders staying Samsung's ITC action against Spansion, holding that the automatic stay applied. According to the bankruptcy court, none of the Section 362(b) exceptions applied.

Specifically, the bankruptcy court cited the *Qimonda* bankruptcy court's decision and held that the police and regulatory powers exception to the automatic stay under Section 362(b)(4) did not apply because the filing of the ITC complaint was purely for the benefit of Samsung, and only incidentally serves the goal of protecting the public from unfair competition. Both Samsung and the ITC filed separate briefs appealing the bankruptcy court's decision to stay the ITC action.

B. Spansion's Arguments

Spansion maintained that the ITC action was properly stayed because it would have violated both Sections 362(a)(1) and (3) of the Bankruptcy Code. First, Spansion pointed to Samsung's withdrawal of its prepetition district court counterclaims as evidence that

¹³ *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).



these same claims could have been commenced with the ITC prior to the bankruptcy under Section 362(a)(1).

Second, Spansion contended that the ITC action was an attempt by Samsung to exercise control over estate property under Section 362(a)(3) of the Bankruptcy Code. Although the nature of an ITC remedy is injunctive, Spansion asserted that if its goods were excluded from the U.S., the net effect would be adverse control over “the core business and property.”

Following the reasoning in the *Qimonda* bankruptcy court’s earlier opinion,¹⁴ Spansion contended that the ITC action was not a valid exercise of police or regulatory power and therefore was not exempt

from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. Despite the fact that the ITC is a governmental entity, Spansion stressed that the ITC action could potentially benefit Samsung’s private interests, and the ITC would merely be adjudicating private rights. Thus, Spansion concluded that the ITC is not an independent entity exercising police or regulatory power on behalf of the general public interest.

C. Arguments of Samsung and the ITC

Regarding Section 362(a)(1)’s application to prepetition claims, Samsung argued that because patent infringement is a continuing tort, a separate cause of action accrues with each instance of infringement. By

filing the ITC action on July 31, 2009, Samsung only purported to resolve post-petition claims occurring on and after that date, therefore falling outside of Section 362(a)(1).

Samsung further argued that the ITC action did not run afoul of Section 362(a)(3) of the Bankruptcy Code because injunctive relief in the form of an ITC exclusion order would not result in a monetary award to Samsung, nor allow it to gain possession of estate property. Similarly, this type of relief would not affect any Spansion products already in the United States that would appropriately be the subject of a district court action.

Both Samsung and the ITC stressed that the ITC action falls within the

¹⁴ No. 09-14766-RGM, 2009 WL 2210771 (Bankr. E.D. Va. July 16, 2009), *rev’d*, *International Trade Commission v. Jaffe*, No. 1:10cv367, 2010 WL 2636096 (E.D. Va. June 28, 2010).

¹⁵ *United States v. Nicolet*, 857 F.2d 202 (3d Cir. 1988).

¹⁶ *Samsung Electronics Co. v. Ad Hoc Consortium of Floating Rate Noteholders*, No. 09-0836 (RBK), 2010 U.S. Dist. LEXIS 64499 (D. Del. June 29, 2010).

¹⁷ *Id.* at **5-6.

¹⁸ *Id.* at *6.

¹⁹ *Id.* Meanwhile, as in *Qimonda*, it appears the ITC proceeded with the investigation at issue, after initially instituting a limited stay. See *Certain Flash Memory and Products Containing Same*, Inv. No. 337-TA-685 (Order No. 10, March 17, 2010), http://www.itc337update.com/uploads/file/PDF_031710-1.pdf (retrieved November 23, 2010).

police or regulatory power exception and therefore is exempt from the automatic stay under Section 362(b)(4) of the Bankruptcy Code. Highlighting certain Third Circuit precedent, Samsung and the ITC argued that the bankruptcy court should apply the pecuniary purpose/public policy test for determining whether the exception applies. Under that test, an action is not exempt from the automatic stay if the government will gain a pecuniary benefit from excluding the goods, or if public policy will not be sufficiently advanced by the injunction.¹⁵ Additionally, Samsung and the ITC asserted that not only will the government not receive any money from the ITC action, but the fact that the exclusion of infringing goods will protect U.S. industry and jobs proves that the action is advancing public policy.

Samsung and the ITC argued that while a Section 337 complaint is initially filed by a private party, such a procedural feature does not alone resolve the regulatory/police power inquiry. They cited several examples where a private party may incidentally benefit from a government action, and the proceeding itself is still exempt from the automatic stay—i.e., Equal Employment Opportunity Commission, National Labor Relations Board, and Federal Trade Commission actions.

Further, Samsung and the ITC argued that other procedural differences from a private lawsuit also reinforced the conclusion that an ITC action is regulatory in nature, such as the ITC's power to institute an investigation upon its own initiative, the ITC's status as the sole appellant on any appeals before the U.S. Court of

Appeals for the Federal Circuit, and the president's power to overturn an ITC exclusion order based on policy concerns.

...exclusion of infringing goods will protect U.S. industry and jobs proves that the action is advancing public policy.

D. Delaware District Court Decision

On Jan. 28, 2010, while the parties' appeals were pending, the bankruptcy court issued an order regarding the ITC action¹⁶ based on a stipulation between the parties—the net effect of which was termination of the stay in the Chapter 15 case on April 30, 2010 and termination of the stay in the Chapter 11 case on May 10, 2010, the latter of which was the effective date of the reorganization plan.¹⁷ As a result of the order, Spansion argued that Samsung's and the ITC's appeals were moot.¹⁸ The ITC responded by filing a letter brief requesting a vacatur of the bankruptcy court's order if the appeals were judged moot.¹⁹

The U.S. District Court for the District of Delaware held that the appeals were moot because no case or controversy existed after the effective date of the plan because the automatic stay was no longer in place.²⁰ The court also vacated the bankruptcy court's prior rulings on this issue so as to preserve the

parties' rights in future litigation.²¹

VI. Application of the Automatic Stay to Cases Seeking Injunctive Relief

As noted above, the U.S. District Court for the District of Delaware did not reach the merits of Spansion's argument that injunctive relief in the form of an ITC exclusion order does not fall within Section 362(a)(3) of the Bankruptcy Code, which applies to actions seeking "control" over a debtor's property. Several courts determined, however, that IP owners seeking injunctive relief from a debtor should be able to pursue their claims in a district court.

In *Larami Ltd. v. Yes! Entertainment Corp.*,²² the U.S. District Court for the District of New Jersey declined to apply an automatic stay as requested by debtor Yes! Entertainment Corp. ("Yes") against plaintiff Larami's patent infringement action, which sought injunctive relief. The court held that because Larami did not seek to control any of Yes's inventory or equipment, and Yes remained in possession of its existing inventory with the opportunity to modify such equipment in order to avoid future infringement, Section 362(a)(3) did not prevent the court from entertaining Larami's patent suit. The court noted that, "[a]t its core, plaintiff's suit is an attempt to prevent allegedly unlawful conduct, not an attempt to directly exercise control over the property of the bankruptcy estate."²³ The court further concluded that, "[i]f [Section 362(a)(3)] were read to prevent the injunctive relief sought here, bankrupt businesses which operated post-

²⁰ *Id.* at **7-8.

²¹ *Id.* at **8-9. Additionally, the vacatur effectually negates the bankruptcy court's decision, which could have otherwise been used as harmful precedent against the ITC and complainants seeking to continue their cases and investigations during a bankruptcy.

²² 244 B.R. 56 (D. N.J. Feb. 3, 2000).

²³ *Id.* at 59.

²⁴ *Id.* at 60.

²⁵ 2010 U.S. Dist. LEXIS 39636 (S.D. Ohio Mar. 25, 2010).

petition could violate patent rights with impunity.”²⁴

The U.S. District Court for the Southern District of Ohio recently reached a similar conclusion in *Dominic’s Restaurant of Dayton Inc. v. Mantia*.²⁵ There, the debtor was accused of infringing the trademark of plaintiff Dominic’s Restaurant of Dayton Inc. (“Dominic”) and, after filing for bankruptcy, attempted to stay Dominic’s infringement action. In declining to apply an automatic stay, the court noted that application of the automatic stay would permit the debtor to continue to commit the tort of trademark infringement—an activity not protected by the Bankruptcy Code.²⁶ The court further noted that while an assessment of monetary damages against the debtor for its continuing tort may have been prevented by the automatic stay, “injunctive relief regarding the use of the property in the commission of a tort” is not prevented by Section 362(a)(3) of the Bankruptcy Code.²⁷

Finally, in *Amplifier Research Corp. v. Hart*,²⁸ the U.S. District Court for the Eastern District of Pennsylvania

held that debtor Amplifier’s tort suit against a rival company, EMCO, was not subject to the automatic stay. Amplifier sought to enjoin further publication of an allegedly defamatory report by EMCO. EMCO argued that injunctive relief would fall within Section 362(a)(3) because prohibiting publication and circulation was tantamount to exercising control over the estate property. The court disagreed and instead sought to clarify the meaning of “control” under Section 362(a)(3)²⁹, noting that “[w]hat Amplifier seeks to ‘control’... is the commission of torts. It does not seek to own EMCO’s report, determine how EMCO uses its report internally, share in the proceeds of the report, use the report itself, or prevent any legal use of the report. It just wants EMCO to stop its tortious acts.” The court also added that if it were to read Amplifier’s request for injunctive relief as an attempt to control EMCO’s property it would produce a “bizarre result”³⁰ and “effectively permit a bankrupt company which stays in business post-petition to commit torts with impunity, a privilege not afforded to non-bankrupts.”³¹

In opposition to the enforcement of the automatic stay, these decisions suggest that IP owners threatened with an “automatic” stay of an ITC investigation instituted *after* the filing of a bankruptcy petition can argue that the “control” provision of Section 362(a)(3) does not apply, and that the regulatory power exception under Section 362(b)(4) does apply.

VII. Practice Tips

No appellate court has addressed the issue of whether the “regulatory power” exception to the “automatic” stay provisions of the Bankruptcy Code applies to ITC investigations, or whether the exclusion orders sought in such investigations constitute “control” under those provisions. The Delaware district court has considered only the first of these issues.

In view of the arguments made by the parties, and the decisions of district courts addressing similar issues, it seems that IP plaintiffs have strategic options to continue to seek injunctive relief, in the form of an ITC exclusion order, even if an infringer threatens or filed for bankruptcy protection.³²

²⁴ *Id.* at * 6.

²⁷ *Id.*

²⁸ 114 B.R. 693 (E.D. Pa 1992).

²⁹ *Id.* at 694–95.

³⁰ *Id.* at 695.

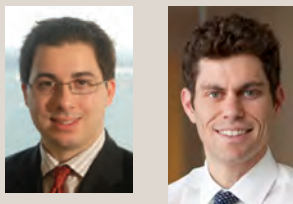
³¹ *Id.*

³² In any event, IP plaintiffs should always retain competent bankruptcy and restructuring counsel familiar with these issues.

Back to the Future (*Lubrizol*): Qimonda Bankruptcy Provides Debtors With a Windfall at the Expense of Their IP Licensees

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Debtors who file for bankruptcy abroad may be able to enjoy the protection of U.S. bankruptcy law while avoiding some of the safeguards available to non-debtor intellectual property licensees.

Qimonda AG, an Infineon Technologies AG spinoff, was once the world's second largest manufacturer of dynamic random access memory, or DRAM. However, this German giant felt the woes of the DRAM market and filed for bankruptcy in a German court in January 2009.

With the boom of global restructurings in the great recession, this story thus far, unfortunately, lacks a unique storyline. However, the Qimonda bankruptcy may have quietly struck a rather astonishing blow to intellectual property licensees' rights.

That is, IP-licensor debtors may file for bankruptcy abroad, yet still enjoy some of the protections of U.S. bankruptcy law under Chapter 15 of the Bankruptcy Code, while avoiding

certain safeguards that the U.S. Bankruptcy Code typically provides to non-debtor licensees.

11 U.S.C. §365(n)— Protections for Non-Debtor Licensees

Intellectual property licenses are usually executory contracts, and debtors have the right to assume or reject executory contracts in a bankruptcy case. Before Section 365(n) of the U.S. Bankruptcy Code, 11 U.S.C. §365(n), if a debtor-licensor rejected its licensee's license, then the licensee would merely have a claim for money damages.

Unless this claim was secured against an asset, it usually was unsecured debt, and the licensee got pennies on the dollar.

Meanwhile, the licensee had no further rights to exploit the debtor-licensor's intellectual property, while the debtor was free to sell or license the underlying intellectual property assets to the highest bidder. Companies that spent millions of dollars on intellectual property licenses and invested in infrastructure and a longterm business model based on these licenses were not content with having their rights abruptly cut off.

This result occurred in the Fourth Circuit's landmark *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.* (In re Richmond Metal Finishers Inc.)

case and led to Congress passing Section 365(n), which gave certain protections to non-debtor licensees and licensors if the debtor counterparty rejects their license.¹

Those protections include the option for the nondebtor copyright or patent licensee to continue satisfying its obligations (e.g., paying royalties) in exchange for having the ability to keep exploiting the debtor-licensor's copyrights or patents.² Although the licensee is not entitled to any prospective rights under the license, such as maintenance or upgrades, it may continue using licensed technology.

While the use continues under the duration of the license, often these rights allow the licensee to plan a prudent transition to a new technology platform or provider.

II. Chapter 15

Congress codified Chapter 15 of the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005³ in order to provide “cooperation between” U.S. courts, trustees, examiners, debtors, and foreign courts “involved in crossborder insolvency cases”; “greater legal certainty for trade and investment”; “fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor”; “protection and maximization of the value of the debtor’s assets”; and “facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.”⁴

In other words,
“a real patent right
to exclude only
arises from the legal
right granted and
recognized by the
sovereign within
whose territory
the right is located.”

Chapter 15 opens the door for a foreign debtor to administer its U.S. assets, enforce contracts, and effectuate claims. Chapter 15 provides, among other things, an ancillary proceeding in the United States to a bankruptcy case taking place in a foreign court.

Often, U.S. law will afford the foreign debtor some of the more prevalent protections under the U.S. Bankruptcy Code. For instance, a U.S. bankruptcy court typically will give the foreign debtor relief under the automatic stay, which, for the most part, keeps creditors away from the U.S. assets during the bankruptcy.

Chapter 15 provides the court with a wide range of discretion in granting various forms of relief at the request of the “foreign representative.” This discretion formed the crux of the dispute between the licensees and licensor in the Qimonda bankruptcy.

III. Qimonda’s Chapter 15 Bankruptcy

After Qimonda commenced an insolvency proceeding in Germany, the German court appointed a foreign

representative to petition a U.S. bankruptcy court for recognition of the German proceeding. The foreign representative filed a petition under Chapter 15, and the U.S. court recognized the case as a “foreign main proceeding,” meaning that it is pending in the country where the debtor has “the center of its main interest”— here, Germany. As a result of this recognition, the U.S. bankruptcy court enjoyed jurisdiction over Qimonda’s U.S. assets.⁵

Shortly after recognizing the German proceeding, the U.S. bankruptcy court issued an order stating that, pursuant to Chapter 15, “the following sections [of the Bankruptcy Code] are also applicable in this proceeding: §§305-307, 342, 345, 349, 350, 364-366, 503, 504, 546, 551, 558.”⁶ About two and a half months later, Qimonda moved to amend the order to strike the reference to Section 365 or to limit the application of Section 365 so that the debtor’s rejection of licenses would be governed by German bankruptcy law.

Predictably, many of the significant licensees objected to Qimonda’s motion to amend, as German bankruptcy law lacks the safeguards that Section 365 affords non-debtor licensees. Specifically, Section 103 of the German Insolvency Code allows the debtor to elect nonperformance of executory contracts.

So, as in *Lubrizol*, Qimonda could elect nonperformance of all its licenses and then liquidate the underlying intellectual assets to the highest bidder.

Despite the fact that Qimonda availed itself of the automatic stay provisions

¹ 756 F.2d 1043, 226 USPQ 961 (4th Cir. 1985).

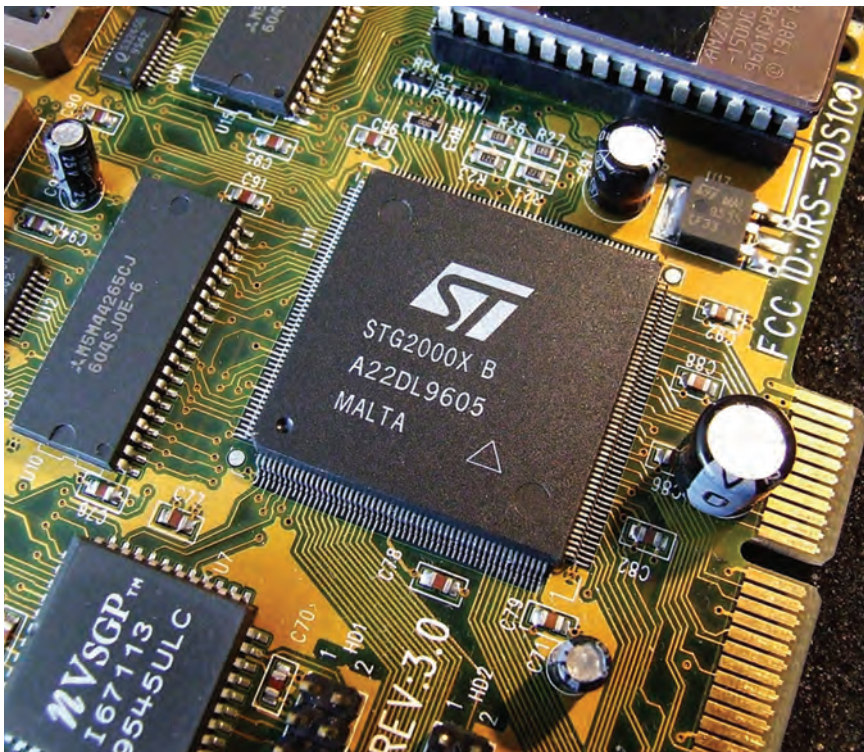
² Trademark licensees are not afforded protection under Section 365(n). For a brief discussion of what is and what is not governed by Section 365, see, e.g., J. Klaiber & B. Reese, Chapter IP: Protecting Your IP When Your Licensee (or Licensor) is Bankrupt, *THE DEAL* (April 17, 2009).

³ Chapter 15 stemmed from the United Nations Commission on International Trade Law’s Model Law on Cross-Border Insolvency.

⁴ 15 U.S.C. §1501.

⁵ It is instructive to note that the licenses at issue involved U.S. patents and that at least one of those licenses was expressly entered into under U.S. law, for example, New York state law.

⁶ Emphasis added.



of the U.S. Bankruptcy Code; despite Congress's clear intent in enacting Section 365(n) to safeguard licensees in good standing against harsh "Lubrizol-esque" outcomes; despite a court order dictating the applicability of Section 365 in the Chapter 15 case;⁷ and despite express provisions in the licenses that called for the application of Section 365(n) and New York law,⁸ the U.S. bankruptcy court granted Qimonda's motion and amended its order.

The amended order states that "Section 365(n) applies only if the Foreign Representative rejects an executory contract pursuant to Section 365 (rather than simply exercising the rights granted to the Foreign Representative pursuant to the German Insolvency Code)."

The U.S. bankruptcy court reasoned that "[i]f the patents and patent licenses are dealt with in accordance with the bankruptcy laws of the

various nations in which the licensees or licensors may be located or operating, there will be many inconsistent results. In fact, the same idea, process or invention may be dealt with differently depending on which country the particular ancillary proceeding is brought."

IV. Conclusion

While the U.S. Court of Appeals for the Federal Circuit has refused to allow lower courts to litigate foreign patent disputes under supplemental jurisdiction theories, the reasoning it used to reach that result seems to run contrary to the bankruptcy court's rationale. For instance, in *Voda v. Cordis*, the Federal Circuit stated that "[a] patent right is limited by the metes and bounds of the jurisdictional territory that granted the right to include."⁹

In other words, "a real patent right to exclude only arises from the legal

right granted and recognized by the sovereign within whose territory the right is located."

The court even noted that the Paris Convention "clearly expresses the independence of each country's sovereign patent systems and their systems for adjudicating those patents," as "[n]othing in the Paris Convention contemplates nor allows one jurisdiction to adjudicate the patents of another, and as such, our courts should not determine the validity and infringement of foreign patents."

"Regardless of the strength of the harmonization trend," the court said, "[p]ermitting our district courts to exercise jurisdiction over infringement claims based on foreign patents ... would require [the Federal Circuit] to define the legal boundaries of a property right granted by another sovereign and then determine whether there has been a trespass to that right."

Just as the Federal Circuit ruled that U.S. courts are not equipped to adjudicate foreign patents,¹⁰ foreign courts are not equipped to administer U.S. patent assets, especially under foreign law.

While foreign insolvencies occur more frequently and more bankruptcy courts interpret their discretion under Chapter 15, patent licensees should pay close attention to how these courts administer patent licenses and the underlying assets. After all, all the time spent in carefully negotiating and drafting a license becomes moot when foreign law allows outright rejection of the license with no continuing rights for the licensee to exploit the licensed technologies.

⁷ On the other hand, the bankruptcy court arguably included Section 365 in the original order to give the debtor the right to assume or reject executory contracts, not necessarily to protect the creditor-licensee's interests.

⁸ U.S. bankruptcy law generally prohibits *ipso facto* clauses, which are terms of a contract that are triggered by a company's insolvency or bankruptcy filing. However, some contractual provisions that deal with the parties' obligations in bankruptcy under Section 365 remain enforceable. See 11 U.S.C. §365(e)(2)(A).

⁹ 476 F.3d 887, 81 USPQ2d 1796 (Fed. Cir. 2007) (73 PTCJ 397, 2/9/07).

¹⁰ Even when they cover identical subject matter as their U.S. brethren.

Back to the Future (*Lubrizol*) Part II: An Update on the Qimonda Bankruptcy

By
Blake Reese
and
Bradley S. Friedman

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Attorneys Blake Reese and Bradley S. Friedman of Milbank, Tweed, Hadley & McCloy, New York, in Part II of their article on the Qimonda bankruptcy case, discuss how the ultimate adjudication of this case might have a significant impact on cross-border commerce in general, as well as on Qimonda's patent licensees.

Qimonda AG, once the world's second largest DRAM manufacturer, filed for bankruptcy in a German court in January 2009. In February, the authors described how Qimonda, by way of Chapter 15 of the U.S. Bankruptcy Code, was able to convince a bankruptcy court that

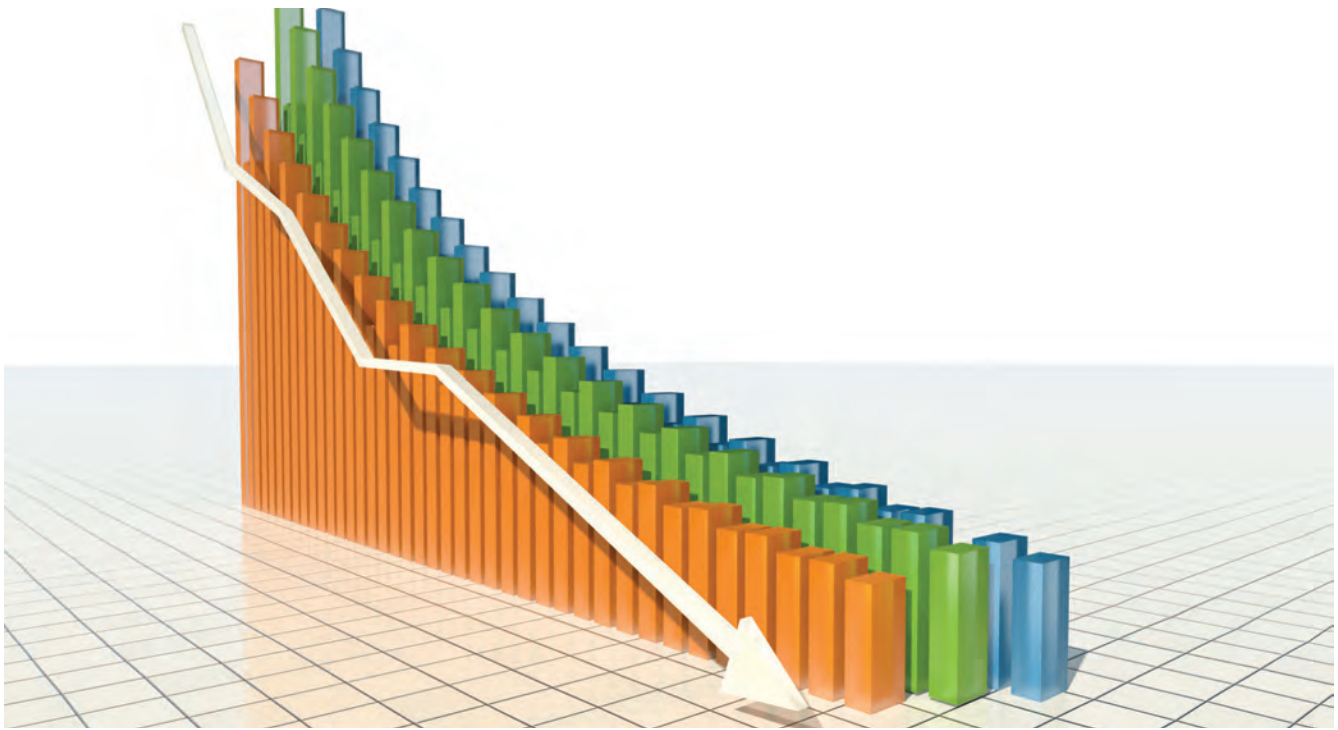
it could avoid certain safeguards typically afforded to non-debtor licensees under Chapter 11 in the name of harmonizing the treatment of a foreign debtor's intellectual property throughout the world.¹ In particular, that German law governed the fate of its licenses and, thus, Qimonda could effectively breach its license agreements and, unlike under U.S. law, its licensees would not have rights to continue exploiting the underlying patents. The ultimate adjudication of this case will have a huge impact on cross-border commerce in general, as well as Qimonda's licensees that rely on rights to at least 4,000 U.S. patents and 1,000 U.S. patent applications. The licensees appealed the bankruptcy court's ruling in favor of Qimonda to the district court, which, on July 2, 2010, issued an opinion regarding this issue of first impression.²

I. Section 365(n)— Protections for Non-debtor Licensees

Intellectual property licenses are usually executory contracts, and debtors have the right to assume or reject executory contracts in a bankruptcy case. Before Section

¹ See *Back to the Future (Lubrizol): Qimonda Bankruptcy Provides Debtors With a Windfall at the Expense of Their IP Licensees* (22 BBLR 316, 3/4/10)(79 PTCJ 488, 2/26/10).

² *Micron Technology Inc. v. Qimonda AG (In re Qimonda AG Bankruptcy Litigation)*, E.D. Va., Nos. 1:10cv26, 1:10cv27, 1:10cv28, 7/2/10 (22 BBLR 975, 7/22/10).



365(n), if a debtor-licensor rejected a license, then the licensee would merely have a claim for money damages. Unless this claim was secured against an asset, it usually was unsecured debt and got pennies on the dollar.

Meanwhile, the licensee had no further rights to exploit the debtor-licensor’s intellectual property, while the debtor was free to sell or license the underlying intellectual property assets to the highest bidder. Companies that spent millions of dollars on intellectual property licenses and invested in infrastructure and a longterm business model based on these licenses were not content with having their rights abruptly cut off. This result occurred in the Fourth Circuit’s landmark *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.* (*In re Richmond Metal Finishers Inc.*) case and led to Congress passing Section 365(n), which gave certain protections to non-debtor licensees

and licensors if the debtor counterparty rejects their license.³

Those protections include the option for the nondebtor copyright or patent licensee to continue satisfying its obligations (e.g., paying royalties) in exchange for having the ability to keep exploiting the debtor-licensor’s copyrights or patents.⁴ Although the licensee is not entitled to any prospective rights under the license, such as maintenance or upgrades, it may continue using licensed technology. While the use continues under the duration of the license, often these rights allow the licensee to plan a prudent transition to a new technology platform or provider.

II. Chapter 15

Congress codified Chapter 15 of the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005⁵ in order to provide “cooperation between” U.S. courts, trustees,

examiners, debtors, and foreign courts “involved in crossborder insolvency cases”; “greater legal certainty for trade and investment”; “fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor”; “protection and maximization of the value of the debtor’s assets”; and “facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.”⁶

Chapter 15 opens the door for a foreign debtor to administer its U.S. assets, enforce contracts, and effectuate claims. Chapter 15 provides, among other things, an ancillary proceeding in the United States to a bankruptcy case taking place in a foreign court. Often, U.S. law will afford the foreign debtor some of the more prevalent protections under the U.S. Bankruptcy Code. For instance, the

³ 756 F.2d 1043 (4th Cir. 1985).

⁴ Trademark licensees are not afforded protection under Section 365(n). For a brief discussion of what is and what is not governed by Section 365, see, e.g., J. Klaiber & B. Reese, *Chapter 15: Protecting Your IP When Your Licensee (or Licensor) Is Bankrupt*, THE DEAL (April 17, 2009).

⁵ Chapter 15 stemmed from the United Nations Commission on International Trade Law’s Model Law on Cross-Border Insolvency.

⁶ 11 U.S.C. §1501.

U.S. bankruptcy court typically will give the foreign debtor relief under the automatic stay, which, for the most part, keeps creditors away from the U.S. assets during the bankruptcy. Chapter 15 provides the court with a wide range of discretion in granting various forms of relief at the request of the “foreign representative.” This discretion formed the crux of the dispute between the licensees and licensor in the Qimonda bankruptcy.

III. Qimonda’s Chapter 15 Bankruptcy

After Qimonda commenced an insolvency proceeding in Germany, the German court appointed a foreign representative to petition a U.S. bankruptcy court for recognition of the German proceeding. The foreign representative filed a petition under Chapter 15, and the U.S. court recognized the case as a “foreign main proceeding,” meaning that it is pending in the country where the debtor has “the center of its main interest”—here, Germany. As a result of this recognition, the U.S. bankruptcy court enjoyed jurisdiction over Qimonda’s U.S. assets.⁷

Shortly after recognizing the proceeding, the bankruptcy court issued an order stating that, pursuant to Chapter 15, “the following sections [of the Bankruptcy Code] are also applicable in this proceeding: §§305- 307, 342, 345, 349, 350, **364-366**, 503, 504, 546, 551, 558.”⁸ About two and a half months later, Qimonda moved to amend the order to strike the reference to Section 365 or limit the application of Section 365 so the debtor’s rejection of licenses would be governed by German bankruptcy law.

In pointing out a “somewhat anemic record,” the district court explained that the bankruptcy court did not give proper reasoning to support its conclusory statements of the apparent interests of the parties.

Predictably, many of the significant licensees objected to Qimonda’s motion to amend, as German bankruptcy law lacks the safeguards that Section 365 affords non-debtor licensees. Specifically, §103 of the German Insolvency Code allows the debtor to elect nonperformance of executory contracts. So, like in *Lubrizol*, Qimonda could elect non-performance of all its licenses and then liquidate the underlying intellectual assets to the highest bidder.

Despite the fact that Qimonda availed itself of the automatic stay provisions of the U.S. Bankruptcy Code; despite Congress’s clear intent in enacting Section 365(n) to safeguard licensees in good standing against harsh “*Lubrizol*-esque” outcomes; despite a court order dictating the applicability of Section 365 in the Chapter 15 case;⁹ and despite express provisions in the licenses that called for the application of Section 365(n) and New York law,¹⁰ the bankruptcy court granted Qimonda’s motion and amended its order.

The amended order states that “section 365(n) applies only if the Foreign Representative rejects an executory contract pursuant to section 365 (rather than simply exercising the rights granted to the Foreign Representative pursuant to the German Insolvency Code).” The bankruptcy court reasoned that “[i]f the patents and patent licenses are dealt with in accordance with the bankruptcy laws of the various nations in which the licensees or licensors may be located or operating, there will be many inconsistent results. In fact, the same idea, process or invention may be dealt with differently depending on which country the particular ancillary proceeding is brought.”

The licensees appealed the bankruptcy court’s decision.

IV. The District Court’s Decision

On appeal, the district court reviewed whether the bankruptcy court (1) properly ensured that the appellants were sufficiently protected in modifying the discretionary relief granted; (2) erred in concluding that Section 365(n) does not automatically apply in a Chapter 15 proceeding; and (3) erred in granting comity to the German Insolvency Code, which treats executory intellectual property license contracts differently from licensees protected under Section 365(n).

A. Balancing the Parties’ Interests Under Chapter 15

The district court explained that Chapter 15 allows a bankruptcy court discretion in “grant[ing] any appropriate relief” necessary to

⁷ It is instructive to note that the licenses at issue involved U.S. patents and, at least one formed under U.S. law, for example, New York state law.

⁸ (Emphasis added).

⁹ On the other hand, the bankruptcy court arguably included Section 365 in the original order to give the debtor the right to assume or reject executory contracts, not necessarily to protect the creditor-licensee’s interests.

¹⁰ U.S. bankruptcy law generally prohibits *ipso facto* clauses, which are terms of a contract that are triggered by a company’s insolvency or bankruptcy filing. However, some contractual provisions that deal with the parties’ obligations in bankruptcy under Section 365 remain enforceable. See 11 U.S.C. §365(e)(2)(A).

“effectuate the purpose of this chapter and to protect the assets of the debtors or the interests of the creditors.” Furthermore, the bankruptcy court, on its own or at the request of the foreign representative or an affected party, “may” modify or terminate such discretionary relief. In modifying or terminating such relief, the bankruptcy court must ensure that “the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.”

...the district court noted the need to address two main factors: (1) whether the foreign proceeding is procedurally unfair; and (2) whether the application of the foreign law would “severely impinge the value and import of a U.S. statutory or constitutional right.”

In pointing out a “somewhat anemic record,” the district court explained that the bankruptcy court did not give proper reasoning to support its conclusory statements of the apparent interests of the parties. With respect to protecting the debtor’s interests, the bankruptcy court did not articulate why application of Section 365(n) would unavoidably “splinter” or “shatter” the Qimonda patent portfolio “into many pieces that can never be reconstructed” which would render the portfolio effectively unsalable. In fact, as the district noted, “were 365(n) to apply

in this case, [the licensees] would retain valid cross-licenses to certain Qimonda patents, and accordingly any ‘splintering’ of Qimonda’s patent portfolio would have no effect on [the licensees] intellectual property interests.” On the other hand, the bankruptcy court did not provide sufficient reasons why the debtor’s demanding that the licensees pay new licensing or royalty fees was an “unfortunate but an inevitable result” of Qimonda’s insolvency. Furthermore, the bankruptcy court failed to consider any information about the nature of the licensed U.S. patents and whether cancellation of the licenses for those patents would put at risk the licensees’ investment in manufacturing or sales facilities in this country for products embodied by those patents.

B. Discretionary (Non-Automatic) Application of Section 365(n)

Through its statutory interpretation, the district court determined that Section 365 applies within the discretion of the bankruptcy court and not automatically in Chapter 15 proceedings. This determination was based on Chapter 15’s explicitly referencing Sections 361-363 and not Section 365 as provisions that automatically apply in a Chapter 15 proceeding. The court explained that while Section 363(l) references Section 365, “it does so only in the context of rendering *ipso facto* clauses unenforceable.” The district court reasoned that not every sale under Section 363 implicates agreements with *ipso facto* clauses and, therefore, Section 365 is only applied within the discretion of the bankruptcy court and not automatically in every sale. In other words, bankruptcy courts can subject asset sales in Chapter 15 proceedings to Section 365, but, if the bankruptcy court does not exercise its discretion, Section 365 will not apply.

C. Public Policy and the Comity of German Law

The district court addressed whether granting comity to German law (i.e. not applying Section 365(n) and applying the German Insolvency Code) was properly decided or an abuse of the bankruptcy court’s discretion. The court noted the two components of Chapter 15: (1) that the bankruptcy court “shall grant comity or cooperation to the foreign representative”; and (2) that nothing in Chapter 15 “prevents the court from refusing to take an action governed by this chapter if the action would be *manifestly contrary to the public policy of the United States.*”

Reading these two complementary sections in *pari materia*, the district court held that any analysis must focus on whether Section 365(n) embodies “the fundamental public policy of the United States, such that subordinating section 365(n) to German Insolvency Code §103 is an action ‘manifestly contrary to the public policy of the United States.’” Citing to the legislative history of Section 365(n) and paying particular attention to Congress’s affirmative steps to change the outcome of the *Lubrizol* decision, the district court noted the need to address two main factors: (1) whether the foreign proceeding is procedurally unfair; and (2) whether the application of the foreign law would “severely impinge the value and import of a U.S. statutory or constitutional right.” Referencing the sparse bankruptcy court record, the district court noted that the bankruptcy court must first determine whether the relief granted violates fundamental U.S. policies under Chapter 15 because the application of the German Insolvency Code and the conditioning of Section 365(n), seemingly without qualification, appear to be at odds with Congress’s intent to reject *Lubrizol*.



As a result, the district court remanded this case to the bankruptcy court in order for it to more fully explain its basis for modifying the discretionary relief previously granted and determine whether the relief granted violated fundamental U.S. public policies.

V. Conclusion

The district court has laid the framework for the bankruptcy court's analysis. Under this framework,

while the bankruptcy court will be forced to justify its decision to modify its initial order to apply Section 365 to the Chapter 15 proceeding, the district court has made clear that a bankruptcy court can avoid such justification by altogether avoiding the application of Section 365 in a Chapter 15 proceeding. In other words, if a bankruptcy court does not modify or terminate an order requiring the application of 365, and, instead, never speaks of

Section 365, it will be operating within its discretion. Accordingly, licensees will be anxiously awaiting the bankruptcy court's finding of whether an application of foreign law that conflicts with Section 365(n) is improper under Chapter 15 for violating fundamental U.S. public policies.

A horizontal band across the middle of the page, featuring a dark background with bright orange and yellow flames and sparks rising from the bottom center. The text "OTHER HOT ISSUES" is centered in white, bold, uppercase letters.

OTHER HOT ISSUES



A (Markup) Language Barrier – i4i v. Microsoft

By
Christopher Chalsen

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from Inside Counsel.



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Supreme Court
to decide major
issue relating to
the presumption
of validity of U.S.
patents

On November 29, the U.S. Supreme Court granted Microsoft's petition for *writ of certiorari* in its dispute with i4i Limited Partnership, which questioned the legal basis for the Federal Circuit's long-standing precept that the presumption of validity of a patent can only be overcome by clear and convincing evidence. As Microsoft requested, the Court will decide whether the evidentiary standard for invalidating a patent should be lessened to a preponderance of the evidence when the asserted invalidating prior art was not considered by the U.S. Patent and Trademark Office (USPTO) during prosecution.

The grant of *certiorari* is sending shockwaves through the patent world, as the Court's decision may make it easier for challengers to invalidate a substantial percentage of the outstanding U.S. patents. Indeed, most invalidity arguments asserted by

defendants at trial are based on prior art that was not cited by USPTO examiners during prosecution.

i4i is a software consulting company that customizes software for other companies. i4i obtained U.S. Patent No. 5,787,449 (the 449 patent), which claims an improved method for editing documents that contain markup languages. Markup languages use tags, called metacodes, that provide information about the content of text or how text should be displayed. The invention claimed in the 449 patent involves a data structure called a metacode map that stores the metacode and a data structure that stores the documents' content, called mapped content. One of i4i's software products is a software "add-on" to Microsoft Word that expands Word's ability to edit documents containing the markup language XML. Certain versions of Microsoft Word have XML editing capability. In 2007, i4i filed an action asserting that Microsoft's manufacture, use, offer to sell, sale and importation of any Microsoft Word with the capability of handling custom XML infringed the 449 patent.

The district court denied Microsoft's motion for judgment as a matter of law on the issue of infringement, willfulness and validity. The jury found that the 449 patent was not invalid,

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– *Chambers USA 2010*

that Microsoft Word infringed the 449 patent, that Microsoft's infringement was willful and awarded \$240 million in damages. After trial, the district court denied Microsoft's renewed motions for judgment as a matter of law and granted i4i's motion for a permanent injunction.

On appeal, Microsoft challenged the district court's claim construction, the jury's findings of infringement and validity, the jury's \$240 million damages award and the district court's entry of a permanent injunction. The Federal Circuit affirmed the verdict in all respects, affirmed the issuance of the injunction, and modified the effective date of the injunction.

In its decision, the Federal Circuit stated, *inter alia*, that all of Microsoft's obviousness arguments involved questions of fact that must be resolved against Microsoft and affirmed the jury verdict on obviousness. Regarding anticipation, Microsoft argued that the sale of a prior software program called S4 invalidated the 449 patent by violating the on-sale bar under 35 U.S.C. §102(b). Microsoft specifically contended that i4i could not rebut Microsoft's *prima facie* case of anticipation by the testimony of the inventors of the S4 software program alone. The court rejected Microsoft's argument because the inventors of the S4 software program provided testimony that the S4 software program did not practice all of the steps of the claimed method. The court also

explained that no requirement for corroboration of the inventors' testimony exists in responding to an attack on the validity of a patent. The court further found sufficient evidence in the record for a reasonable jury to conclude that the sale of the S4 software program did not anticipate the '449 patent by clear and convincing evidence.

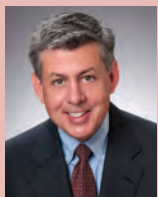
The presumption of patent validity is statutory, found at 35 U.S.C. 282. The assignment of the burden of proving invalidity based on clear and convincing evidence has a long history in Federal Circuit decisions, based on the Court's deference to the USPTO's ability to do its job. However, the specific allocation of the "clear and convincing" standard is not explicitly stated in the statute. The Supreme Court's decision, if it recognizes that the higher standard should not be applicable to situations where the PTO examiners did not consider the prior art asserted to prove invalidity, could make it easier for alleged patent infringers to invalidate accused patents. Under the reduced standard of preponderance of the evidence, the alleged infringers would only have to show that it is more likely than not that the accused patent is invalid. Thus, the Court's decision could have a profound effect on challenges to existing patents in situations where the asserted prior art was not considered by the USPTO.

Milbank associate Blake Reese contributed to this column.

Divided Congress May Create Perfect Storm for Patent Reform

By
Mark C. Scarsi

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from Inside Counsel.



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Both democrats and republicans have a history of ignoring patent reform when they control Congress, but the current divide could lead to action.

The promise of Patent Reform reminds me a bit of Lucy's perennial football prank on Charlie Brown in the Peanuts comic strip. Every year Congress tees up a reform package designed to cure the ills of the Patent System, patent practitioners and business owners get excited about the first real reform of the patent system in decades and then, like Lucy, Congress yanks the ball away by closing its legislative session without taking action.

This past year was no different. In March, the Senate introduced the Patent Reform Act of 2010. The Act included a number of measures to provide clarity in the patent system and to curb patent litigation abuses. For example, the 2010 Act provided guidance on patent damages, raised the bar for finding willful infringement, discouraged

forum shopping and eliminated false marking suits where the plaintiff could not show competitive damage. All in all, the 2010 Act was seen as pro business and a good first step towards much needed systemic change.

The Act also had broad support. In September 2010, a bipartisan group of 25 senators (14 Democrats, 10 Republicans and one Independent) sent a letter to Senate Majority Leader Harry Reid encouraging him to bring the Act to the Senate floor for consideration. In making their case, the bipartisan group promoted their view that a well functioning patent system would help stimulate the economy and create jobs. Unfortunately, with a majority in both houses and a Democrat in the White House, Senator Reid had bigger fish to fry. Reid's office issued a statement indicating that while Patent Reform was "an important issue, we have many items to consider before the end of the year and not much time to consider them."

Senator Reid's failure to take up Patent Reform while the Democrats had control of Congress is not without precedent. In fact, the Republicans failed to pass the Patent Reform Act of 2006 when they had control of both houses and President Bush sat in the Oval Office. If there is a lesson to be learned from these failures, it might be that Patent



Reform is just not partisan enough to make it to the top of either party's agenda. If that's the case, the current divided Congress may create the perfect storm for action on Patent Reform.

The Democrats in the new Congress have pledged to work toward bipartisan cooperation to help the economy and create jobs. Both parties agree that Patent Reform meets these goals. The Republicans

have also pledged bipartisan cooperation, but have promised to hold their position on hot button topics such as tax cuts, health care and new spending. Patent Reform implicates none of these issues. While most commentators dismiss the promises of bipartisanship and predict nothing but gridlock from the new Congress, Patent Reform would seem to be one issue where Democrats and Republicans can come together.

As luck would have it, the bipartisan group of senators who urged Majority Leader Reid to take up Patent Reform last September have largely survived the recent election. If they can be encouraged to renew their efforts, 2011 could finally be the year when Congress breaks the "Lucy-and-the-football" cycle and enacts Patent Reform.

Obvious to the Most Casual Observer?

By
Christopher Chalsen

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from Inside Counsel.



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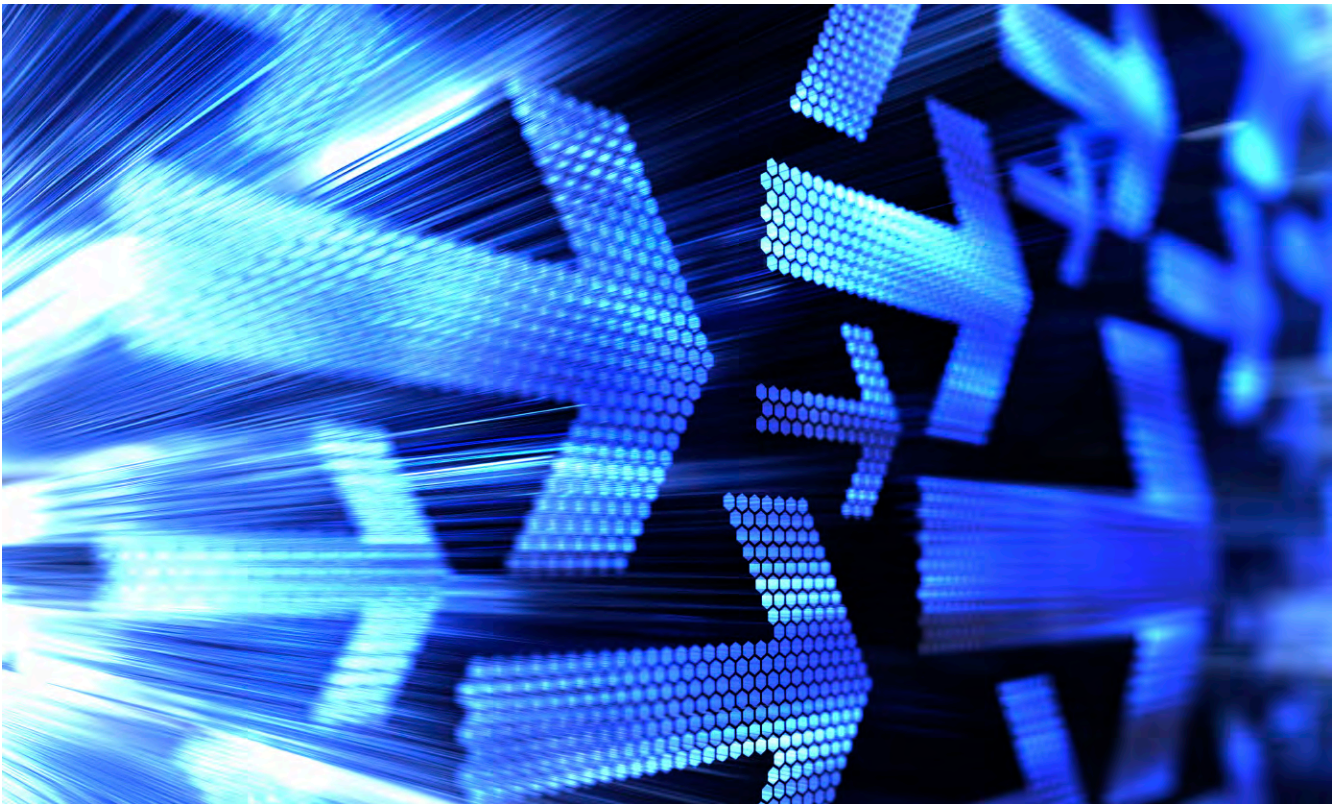
Common sense test has been applied in some obviousness arguments, but its overall weight has been relatively limited.

One of the most frustrating expressions I came across in my college mathematics texts was “and, as would be obvious to the most casual observer...” I always thought to myself, “What? Obvious to you maybe.”

Later, I became exposed to a new kind of analysis that also used the word “obvious” – the non-obviousness test for patentability under 35 U.S.C. Sec. 103. This test seemed simple enough: Would a claimed invention have been obvious at the time it was made to a person of ordinary skill in the art? Since it was an objective analysis based on the differences between the prior art and the claimed invention, it seemed eminently more rationale than “obvious to the most casual observer” test. But, of course, its application was far from simple.

Starting in 1983, the Federal Circuit developed successively more objective refinements of the obviousness test, culminating in the teaching-suggestion-motivation (TSM) test. Under TSM, a patent claim could be found obvious based on a combination of prior art references only if a teaching, suggestion or motivation to combine those references was also in the prior art. While the objectivity of this test was laudable, its strict application lead to some perplexing results, for example, patents on such seemingly obvious inventions as crust-less peanut butter and jelly sandwiches or methods of swinging on toy swings. Even such casual observers as the *Wall Street Journal* and the *New York Times* began to take note.

So, in *KSR Intl. Co. v. Teleflex Inc.*, the Supreme Court rejected the rigid TSM approach to obviousness. Although finding the TSM test to be a “helpful insight,” the Court held that it had been applied by the Federal Circuit in an overly formalistic manner inconsistent with prior precedents. Cautioning that courts must still conduct an explicit obviousness analysis, the Court explained that factors such as design needs, market demands, and “common sense” may provide sufficient reasons for combining prior art elements.



In the last few years, the latter factor, “common sense,” has received considerable attention since some feared that reliance on common sense could bring about widespread rulings of obviousness based on hindsight. Generally speaking, these concerns have not been realized – yet. While common sense has been used in certain obviousness arguments, its overall weight in the inquiry has been reasonably limited.

Courts have employed the common sense consideration for different uses. In *Wyers v. Master Lock Co.*, the Federal Circuit found that common sense provided the motivation for combining the prior art even where expert testimony was not presented on one of the prior art references. The Court had no problem with such logic as results were predictable.

Similarly, in *Sundance, Inc. v. Demonte Fabricating Ltd.*, the Court found retractable tarpaulins used to cover truck trailers to be a simple

technology and stated that no expert testimony was needed to apply the disclosure of the prior art to the asserted patent. Common sense here was akin to taking judicial notice of the combination of elements.

Common sense has also been used to supply a missing claim element. In *Perfect Web Techs., Inc. v. InfoUSA, Inc.*, the patented technology involved a four-step method of handling and processing bulk e-mail where the first three steps were disclosed in the prior art. The last step involved repeating the earlier steps until a specified number of e-mails have been successfully received. The Court found the last step of repeating a known procedure until achieving success to be simply a matter of common sense.

However, where possible solutions to a problem were numerous, as in *Rolls-Royce, PLC v. United Techs. Corp.*, common sense reasoning did not make a particular solution obvious to

try, and the Federal Circuit affirmed a holding that claims to a fan blade used on a jet engine were not obvious.

Similarly, blind reliance on common sense without sufficient reasoning has been found insufficient. In *TriMed Inc. v. Stryker Corp.*, the Federal Circuit reversed a grant of summary judgment where the district court provided only conclusory reasoning that the prior art combination was a common sense solution. The Federal Circuit admonished the lower court: “saying that an invention is a logical, common sense solution to a known problem does not make it so.” In other words, simply saying something would have been obvious to the most casual observer is not a particularly helpful or convincing step in a proof.

Milbank associate Nate Broward contributed to this column.

The Central District of California: Effectively Navigating the New Home for Patent Litigation

By
Mark Scarsi

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The Northern and Central Districts of California became a preferred venue for the growing number of patent cases that accompanied the high-tech boom.

Introduction

In recent months, the U.S. District Court for the Central District of California has seen a marked increase in patent cases. This district has long ranked in the top five in the nation in terms of patent litigation, but it now sits in the number one slot with more patent cases than any district in the country. This shift comes on the heels of changes occurring in the Eastern District of Texas, which has long been an attractive forum to plaintiffs in patent cases, as well as a sudden increase in the number of plaintiffs' firms in the Los Angeles area filing suit close to home.

The Central District of California brings about new issues and a different way of operating for many attorneys who have become comfortable with the rules, the judges, and the certainty of the

Eastern District of Texas. Attorneys must be prepared to operate within a new set of guidelines and get to know a new group of judges, each with their own preferences, expectations, and interpretations of the rules.

The Move From California to Texas—A Brief History

California has a rich history of patent litigation. With many of the high-tech companies that sprang up in the 1990s based on the West Coast (either in the L.A. Basin or the Bay Area), the Northern and Central Districts of California became a preferred venue for the growing number of patent cases that accompanied the high-tech boom.

In fact, the Northern District sensed the coming surge of patent cases and began adopting specialpurpose rules to more effectively handle their expanding caseload. Those rules required mandatory disclosures along a particular schedule and led to a consistency in the Northern District with regard to the management of patent cases. This put the Northern District on the map as an example of an innovative and interesting model of patent case management.

Around 2004, the Eastern District of Texas emerged as an attractive alternative forum for patent cases. The appeal of this district centered on the rules it adopted to govern patent

cases, similar to those instituted in the Northern District of California years earlier; however, the rules governing the Eastern District of Texas allowed for a faster litigation process.

What would take 60 days in California would now take 30 days in East Texas. Additionally, there was also a notion that juries in East Texas were more likely to side with patent holders due to a perception that they had more trust in government and would have more respect for a patent issued by a government-run entity. This perception, coupled with the speed the rules provided, led to a growing number of plaintiffs filing suit in this district to ensure a faster, more successful trial.

Patent Litigation Has No Permanent Address

Perhaps one of the most interesting aspects of patent cases is that they can literally occur in any state and district in America. Because products entered into the stream of commerce in the United States can end up in any state, there is no bar against filing a patent lawsuit in any district of the United States, as long as there can be personal jurisdiction.

Any court can have subject matter jurisdiction, and the only measure available to regulate this is the nonconveniens motion under 28 U.S.C. §1404, which allows for petitions to move a patent trial to a more convenient location. However, courts have a great deal of latitude when it comes to transferring cases, and it is ultimately up to the discretion of the court whether or not to transfer a case.

The Eastern District of Texas became legendary for never transferring cases, and over time, attorneys simply stopped attempting a petition for transfer because they were almost guaranteed a denial. Recent action

The Eastern District of Texas became legendary for never transferring cases, and over time, attorneys simply stopped attempting a petition for transfer because they were almost guaranteed a denial.

by the Federal Circuit, however, is changing that trend. In *In re TS Tech USA Corp.*, 551 F.3d 1315, 89 USPQ2d 1567 (Fed. Cir. 2008) (77 PTCJ 243, 1/9/09), the fears of many patent case litigants came true as the appellate court cited the reasoning in a non-patent case and transferred a case out of the Eastern District of Texas.

Courts in that district have relied on *TS Tech* in granting an increasing number of transfer motions. See, e.g., *S.E.C. v. Rizvi*, No. 4:09cv00371, 2010 WL 2949311 (E.D. Tex. July 2, 2010); *Orinda Intellectual Property USA Holding Group Inc. v. Sony Corp.*, No. 2:08cv00323, 2009 WL 3261932 (E.D. Tex. Sept. 29, 2009); and *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995 (E.D. Tex. 2009).

In fact, there is now a somewhat greater chance that if your case is filed in the Eastern District of Texas, and there is no real connection to that forum, the court may grant a motion to transfer to a more convenient location.

The Move Back to California

The shift in transfer decisions in the Eastern District of Texas has coincided with a docket in that

district that is increasingly jammed. With only three judges throughout the district, all with full dockets, the speed that was once such an appealing aspect of the district is no longer its biggest draw. Attorneys are now more likely to get a case transferred out of East Texas, and plaintiffs are more likely to look elsewhere in their attempt to ensure a speedy trial.

While the Eastern District of Texas has decreased in patent case popularity, the Central District of California is experiencing a clear upward trend in the number of patent cases filed. It is now first in the nation with the most patent cases filed.

Led by the growing number of plaintiffs firms that have opened in the Los Angeles area over the past few years, this district has seen a rising number of patent cases filed by attorneys more comfortable with the Los Angeles courts that are close to home.

Navigating Patent Litigation's New Home

Whereas the Eastern District of Texas and the Northern District of California have a defined set of rules that govern their patent cases, the Central District of California does not. Each case that is tried is unique, and judges have more flexibility surrounding what rules they choose to adopt.

Judges in the Central District fall into three broad categories: 1) those who choose to adopt the rules of the Northern District of California on a consistent basis; 2) those who will adopt those rules upon request of the parties involved; and 3) those who prefer the flexibility of no specific patent rules. One of the most important things to be aware of when facing patent litigation in the Central District is which category your judge falls within.



There are certainly advantages and disadvantages to each category. For example, if a court adopts the rules of the Northern District, there is a greater sense of certainty about how the case will proceed. On the other hand, for courts giving you the option of whether or not to operate within those rules, you must make sure that those rules will work to the greatest benefit of your client before proceeding.

Courts operating independently of the rules can often provide a flexibility that does not commonly accompany patent cases. This can lead to more creative litigation and provides an opportunity to make things happen earlier than you could in a district governed by strict schedules.

So if you are before a judge that doesn't adopt the patent rules, you have the flexibility to try to bring about some leverage early in the case. Examples of this include trying to get the court to rule on summary judgment early in the case by doing a partial construction of some of the claim terms or attempting to get

the court to look at issues such as inventorship early on.

Another important note is that there are between 20 to 30 judges in the Central District (compared to three in the Eastern District of Texas). While this leads to a faster schedule than other districts, with trial dates set a year and a half to two years out, this also makes it impossible to predict where your case will land—making it essential to take the time to familiarize yourself with each judge.

Know their temperament, their expectations of counsel, and what rules govern their courtroom. This is a fairly strict district, with high expectations for counsel and a firm respect for the rules. Being prepared and informed will help you to operate effectively here. Attorneys facing patent litigation in the Central District should also be aware of the difficulty that discovery motions pose. There is an elaborate and detailed meet and confer process that makes it more difficult to succeed on a discovery motion, and working with opposing counsel is essential.

More cooperation is required between the parties, and a strong working relationship with opposing counsel must be established early on. For example, you must file a joint statement that identifies the discovery dispute, and both sides must submit portions of the joint statement. This requires working on the filing together. Accordingly, a professional relationship with opposing counsel will be of great service to your client.

Conclusion

The Central District of California offers attorneys facing patent litigation numerous advantages as long as they are fully prepared and informed before they enter the courtroom. Flexibility, speed of schedule, more creative litigation, and a larger pool of judges all make this an attractive district for patent cases, and its popularity will likely continue to expand in the coming months and years.

If this trend is maintained over the long term, patent litigation may ultimately find a new district to call home.

Predicting the Future of Patent Misuse Remedies

By
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A common-law defense to patent infringement is the “patent misuse” doctrine, which is designed to remedy anti-competitive actions of patent owners who attempt to impermissibly broaden the scope of their patent grants.

Although patent misuse has been alluded to for over a century, the U.S. Supreme Court did not establish the doctrine until 1942.¹ Since then, the patent misuse doctrine has developed significantly. But even today, the doctrine is plagued with inconsistent standards and unresolved issues. For instance, courts have struggled to devise a universal remedy under the doctrine, one that strikes a balance between curtailing anti-competitive effects and the innovative purpose of U.S. patents.

Recently, the Federal Circuit further defined the concept of patent misuse and tailored appropriate remedies for the defense. Notably, the court endorsed limited, compulsory licensing as a practical remedy in other patent contexts, and it may be inclined to extend such a remedy to misuse cases, too. Transactional attorneys and in-house counsel should be aware of this recent case law when negotiating and drafting intellectual property licenses, so they can avoid common mistakes that often lead to patent misuse findings.

Patent litigators should be cognizant of the recent developments, too, especially when devising patent misuse remedies for courts to adopt at trial.

An Overview of the Patent Misuse Doctrine

Patent misuse is an affirmative defense to a claim of patent infringement where the patentee has “impermissibly broadened the physical or temporal scope of the patent grant with anti-competitive effect.”² Application of the doctrine remains controversial.

Notably, its significant overlap with antitrust law has spawned a debate over whether misuse and antitrust are, in fact, coextensive. While some argue that all instances of genuine patent misuse necessarily constitute antitrust violations, others believe misuse encompasses behavior beyond the scope of antitrust.

Generally speaking, there are two types of prohibited activity that can lead to a finding of patent misuse: (1) antitrust violations sufficiently related to the patent in question to sustain a misuse finding; and (2) instances in which a patent owner seeks to extend its exclusive rights beyond those guaranteed by the patent grant. These two categories

¹ See *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942).

² *Va. Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 868 (Fed. Cir. 1997) (quoting *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986)).

roughly track the “two basic ... perceived evils” with which the patent misuse doctrine is concerned, namely, “the use of patents to undermine competition” and “the expansions of patent rights beyond their lawful scope.”³

Over the years, courts have identified several prohibited practices that constitute per se patent misuse. The first category involves tying arrangements where the patent owner requires in a license agreement that the licensee of the patent also purchase a separate, staple good. The second category includes arrangements allowing patent owners to effectively extend the terms of their patents, such as by requiring royalty payments after the patents have expired.

When an action alleged to constitute patent misuse is not per se patent misuse, a court may still find a violation. The court may determine if the patent holder’s actions are reasonably within the patent grant, i.e., if they relate to subject matter within the scope of the patent claims. If the alleged actions are reasonably within the patent grant, the practice likely does not have the effect of broadening the scope of the patent claims and thus may not constitute patent misuse.

On the other hand, if a practice has the effect of extending the patent owner’s exclusive rights, and does so with an anti-competitive effect, the conduct may be analyzed in accordance with the “rule of reason.” The fact finder may decide whether the questioned practice imposes “an unreasonable restraint on competition, taking into account a

Though the Federal Circuit has defined patent misuse as behavior with an “anti-competitive effect,” the standard of proof for such a showing is unclear.

variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint’s history, nature, and effect.”⁴ The rule of reason seeks to determine whether the challenged actions promote or suppress competition. A patent holder’s actions that suppress competition may result in a patent misuse finding.

Tying Arrangements

Most patent misuse cases involve an allegedly prohibited “tying” arrangement.

Traditional “patent-to-product” tying arrangements are those in which a patent owner uses the market power conferred by the patent to compel customers to purchase or lease a product in a separate market that the customer might otherwise purchase or lease from a competitor.⁵ Classic examples include conditioning the lease of a patented salt depositing machine on the purchase of salt from the patentee,⁶ and the refusal to permit use of a meat processing patent unless the user leases the patentee’s “macerator” machine.⁷

Early courts viewed tying arrangements as per se patent misuse: as long as a defendant could prove some form of tying arrangement, misuse was assumed, regardless of the patentee’s market power in the tying product market, the tying arrangement’s actual anticompetitive effect, or the relationship between the tied items. Liberal acceptance of tying claims culminated in *Mercoïd Corp. v. Mid-Continent Invention Co.*, where the Supreme Court found misuse based on the tying of a product (a combustion switch) that was essential to and had no use beyond the patented invention (a domestic heating system).⁸

Since *Mercoïd*, Congress has limited the scope of the misuse doctrine with the 1952 Patent Act (distinguishing prohibited tying of “staple” goods from potentially legitimate tying of “non-staple” goods) and the 1988 Patent Misuse Reform Act (requiring a showing of “market power” before tying becomes misuse).⁹ Subsequent case law reflects this legislative reform, with courts validating tying claims only where the separate item allegedly tied to the patented item is a staple item in commerce and the patentee has market power in the tying product market.¹⁰

The Modern Patent Misuse Doctrine: Inconsistencies and Unresolved Issues

Notwithstanding efforts by the Federal Circuit to standardize application of the patent misuse doctrine and a general trend towards constricting its use, uncertainty persists even today.¹¹

³ Herbert Hovenkamp et al., *IP and Antitrust* §3.2 at 3-7 (2009).

⁴ *State Oil v. Khan*, 522 U.S. 3, 10 (1997).

⁵ *U.S. Philips Corp. v. Int’l Trade Comm’n*, 424 F.3d 1179, 1190 (Fed. Cir. 2005).

⁶ *Morton Salt*, 314 U.S. at 488.

⁷ *Senza-Gel Corp. v. Seiffhart*, 803 F.2d 661, 663 (Fed. Cir. 1986).

⁸ 320 U.S. 661, 667-68 (1944).

⁹ 35 U.S.C. §271(d)(5).

¹⁰ *Senza-Gel*, 803 F.2d at 667-69.

¹¹ *Senza-Gel*, a tying case, is the only case in which the Federal Circuit actually found patent misuse. *Id.* at 661. This was before the 1988 Patent Misuse Reform Act; it is unclear what result the court would reach in that case today.



For instance, in the tying context it is still unresolved as to what is necessary to satisfy the statutory requirement that “the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.”¹² While the Supreme Court has provided guidance on this issue in the antitrust setting,¹³ some authorities disagree over the standard applied in patent misuse cases and whether a “market power” requirement forecloses findings of *per se* patent misuse.

Though the Federal Circuit has defined patent misuse as behavior with an “anti-competitive effect,” the standard of proof for such a showing is unclear. Patents (and package licenses in particular) present a unique theoretical challenge, since they can be characterized as naturally anti-competitive. To find misuse, courts must determine the point at which a

patent hinders competition beyond the point contemplated by patent law (a threshold which, presumably, strikes an optimal balance between innovation and competition). To the extent the patent misuse doctrine originated in antitrust, one might assume antitrust standards would be at least relevant in making this determination. Authorities remain split on the issue, however, with some calling for wholesale importation of antitrust doctrine, and others advocating for use of antitrust *analysis* while setting a lower “anti-competitive effect” threshold for a finding of patent misuse.¹⁴

Another point of uncertainty involves the use of coercion in package license cases. In *Philips Corp. v. Int’l Trade Comm’n*, the Federal Circuit jettisoned an earlier analytical framework that focused on the “voluntariness” of package license deals when evaluating misuse claims.¹⁵

Unlike the panel in *Engel Industries v. Lockformer*,¹⁶ which denied a misuse defense on grounds that the licensing agreement at issue was voluntary, the *Philips* panel based its misuse analysis primarily on the competitive effects of the licensing arrangement, declining to find misuse despite indications of involuntariness. According to one commentary, *Philips* “signals an inclination on the court to replace the unworkable voluntariness standard with a more economically reasonable alternative.”¹⁷

Searching for an Appropriate Form of Relief

Even when patent misuse is found, there is no precise methodology for determining an appropriate remedy.

The traditional remedy for patent misuse is effectively a royalty-free, compulsory license to anyone that used the patent at issue. A court

¹² 35 U.S.C. §271(d)(5).

¹³ *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006) (rejecting *per se* rule of illegality in antitrust cases involving tying arrangements, and requiring plaintiff to prove defendant has market power in tying product)

¹⁴ See, e.g., *USM Corp. v. SPS Techs., Inc.*, 694 F.2d 505, 512 (7th Cir. 1982); *Windsurfing Int’l Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986); Mark A. Lemley, *The Economic Irrationality of the Patent Misuse Doctrine*, 78 Cal. L. Rev. 1599 (1990); see also *C.R. Bard, Inc. v. M3 Systems, Inc.*, 157 F.3d 1340, 1372 (Fed. Cir. 1998); *B. Braun Med. Inc. v. Abbott Labs.*, 124 F.3d 1419, 1428 (Fed. Cir. 1997); *Va. Panel*, 133 F.3d at 869; *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992).

¹⁵ 424 F.3d 1179, 1187 (Fed. Cir. 2005).

¹⁶ 96 F.3d 1398 (Fed. Cir. 1996).

¹⁷ Herbert Hovenkamp et al., *IP and Antitrust* §3.2 at 3-7 (2009).

will neither enjoin infringement of the patent nor award damages to the patentee, regardless of whether the patent is otherwise valid, and even where the party claiming the affirmative defense was not itself harmed by the misuse. The offending patentee forfeits its rights until it abandons the prohibited behavior and the effects of the misuse have “fully dissipated.”¹⁸

Yet federal courts have not fully clarified the scope of the patent misuse remedy. Does the compulsory license always extend to the world upon a finding of patent misuse, or can courts limit it to a certain group of accused defendants? Can the court impose a reasonable royalty to be paid on the compulsory license? If so, who decides what the reasonable royalty is? When is misuse “fully dissipated”? The Federal Circuit has not squarely addressed these issues. In fact, only one case was found in which the Federal Circuit affirmed a finding of patent misuse. In doing so, the court simply restated the traditional patent misuse remedy without further instruction: “All that a successful defense of patent misuse means is that a court of equity will not lend its support to enforcement of a mis-user’s patent.”¹⁹

Arguably, the Federal Circuit has made a strategic choice to curtail the patent misuse doctrine by narrowing the definition of “misuse” itself (*i.e.*, by focusing on “market power” and “anti-competitive” effects), rather than narrowing the *remedy* for misuse. This focus on the front end of

Hybrid cases tend to adopt more flexible, targeted remedies than those applied in patent misuse cases.

the issue, while making it harder to succeed on a misuse claim, does not mitigate the significant back-end incentive for bringing such a claim. Indeed, where the contours of “misuse” approach those of antitrust violations, the patent misuse remedy is increasingly an outsized anachronism, arguably rewarding (in the name of equity) infringers who would lack standing under any legal antitrust theory.

The introduction of an “anti-competitive effect” requirement for a showing of patent misuse further raises the question: What behavior does the patent misuse doctrine deter that is not already deterred by antitrust law? One possibility, suggests Judge Richard Posner, “is that the doctrine of patent misuse, unlike antitrust law, condemns any patent licensing practice that is even trivially anti-competitive, at least if it has no socially beneficial effects”²⁰ And yet, if this is the case, why is the patent misuse remedy stricter than the remedy for antitrust violations? Why should misuse be a complete affirmative defense to infringement, whereas antitrust remedies are restricted to treble damages, injunctions against anti-competitive conduct, divestiture

of illegal acquisitions or, in rare cases, a compulsory license where the licensee receives reasonable royalties determined by the court?

Adding further complexity to the issue of appropriate remedies are hybrid cases in which courts ruled on antitrust violations that would likely have constituted patent misuse if raised as affirmative defenses to infringement allegations. Indeed, it is unclear what weight the discussion of remedies in these hybrid cases should carry. First, there is the problem of characterizing the cases. The Supreme Court’s decision in *U.S. v. Glaxo Group Ltd.* is illustrative.²¹ There, the majority cited two “hybrid” cases for the proposition that “mandatory selling on specified terms and compulsory patent licensing at reasonable charges are recognized antitrust remedies”; however, Justice William Rehnquist, in his dissent, relied on the same two cases in arguing that “compulsory licensing is a recognized remedy in *patent misuse cases*.”²² Nonetheless, regardless of how hybrid cases are categorized, it appears the Federal Circuit could today tailor its misuse remedies using such cases as precedent.

Additionally, hybrid cases tend to adopt more flexible, targeted remedies than those applied in patent misuse cases. For example, in *International Salt Co. v. U.S.*, the Supreme Court sanctioned a compulsory license based on reasonable royalties, noting the district courts’ “large discretion to model their judgments to fit the

¹⁸ *B.B. Chemical Co. v. Ellis*, 314 U.S. 495, 498 (1942). Some courts have characterized patent misuse as an application of the equitable doctrine of “unclean hands” —*i.e.*, one who uses his patent grant to subvert the patent system’s underlying public policy goals “may not claim protection of his grant by the courts.” See, *e.g.*, *Morton Salt*, 314 U.S. at 492. The analogy is tenuous, however, since the remedy for patent misuse bars both equitable and legal relief, whereas the unclean hands doctrine bars only equitable relief. Furthermore, the patent misuse doctrine, unlike the unclean hands doctrine, requires no showing of relationship between the plaintiff’s act and the recovery he is denied.

¹⁹ *Senza-Gel*, 803 F.2d at 668.

²⁰ *USM*, 694 F.2d at 511.

²¹ 410 U.S. 52 (1973).

²² *Id.* at 64, 72 n.5 (emphases added) (citing *International Salt Co. v. U.S.*, 332 U.S. 392 (1947), and *Hartford-Empire Co. v. U.S.*, 323 U.S. 386 (1945)). In *International Salt*, the patentee conditioned machine leases on the purchase of the patentee’s salt (a staple good), while in *Hartford-Empire* the defendant used a combination of machine patents to control the price and volume of unpatented glassware. As a technical matter, the majority’s categorization of the cases as antitrust-innate is correct—while both *International Salt* and *Hartford-Empire* involve behavior that closely resembles the tying arrangements at issue in classic patent misuse cases, neither involves an affirmative defense to infringement, and therefore neither constitutes a patent misuse case *per se*.

exigencies of the particular case” and the defendant’s ability to appeal for modification of the decree after a showing of relevant facts.²³ In *Besser Mfg. Co. v. U.S.*, another hybrid case, the Court granted compulsory licenses to existing lessees, with “fair royalties” determined by a four-person committee selected by both defendant and plaintiff.²⁴

The Supreme Court limited the scope of antitrust remedies in *Hartford-Empire Co. v. U.S.*, holding that compulsory licensing at a “price to be fixed by the court” is confiscatory in effect and unwarranted.²⁵ While the Court enjoined prosecution of infringement actions pending at the time of the suit, and granted standard royalty licenses to accused infringers, it held that the remedy should not deny recovery for postdecree infringements of patents unrelated to those immediately at issue. In short, the *Hartford-Empire* Court limited remedies to those entities affected by the offending behavior and to those patents involved in the offense.

Qualcomm and Princo: Products, Standards, and Patent Pools

Two recent cases on appeal have given the Federal Circuit a chance to further consider the scope of the patent misuse doctrine and its available remedies.

In the first case, *Qualcomm v. Broadcom*, the Federal Circuit held several patents unenforceable under the affirmative defense of waiver because the patent holder failed to disclose its patents to an industry standard-setting organization responsible for the H.264 video

Despite the Federal Circuit’s decision in *Princo*, one cannot help but speculate as to the appropriate remedy if patent misuse had been found.

compression standard.²⁶ Although the 2008 decision was technically not based on the misuse doctrine itself, it nonetheless reflects the Federal Circuit’s disfavor of broad equitable remedies that do not constitute “a fair, just and equitable response reflective of the offending conduct.”²⁷ Notably, the *Qualcomm* court reversed a district court ruling that would have rendered plaintiff’s patents unenforceable “to the world.” Finding the scope of this remedy too broad, the Federal Circuit conducted a “patent misuse” remedy analysis.²⁸ This resulted in the court vacating and remanding the case with “instructions to narrow the scope of unenforceability” to products that satisfied a specific nexus requirement—i.e., products that complied with a technical standard related to the patent holder’s inequitable conduct.²⁹ This remedy is, in effect, a royalty-free compulsory license for all manufacturers of products meeting the relevant industry standard.

Just recently, on August 29, 2010, the Federal Circuit issued an *en banc* opinion in *Princo Corp. v. Int’l Trade Comm’n*, sustaining a decision by the

International Trade Commission that the patent misuse doctrine did not bar U.S. Philips Corp. (“Philips”) from enforcing certain patents against Princo Corp.³⁰ The patents-in-suit (the “Raaymakers patents”) covered certain technology used to practice the “Orange Book” industry standard governing CD-R/RW technology, which was jointly developed by Philips and Sony. Philips and Sony had designed a package-licensing scheme whereby they agreed to license the Raaymakers patents in a patent pool that also included the “Lagadec” patent. According to Princo, the Lagadec patent was incompatible with the Orange Book standard and covered technology that was a viable alternative to the standard.

On appeal, Princo claimed that Philips’ and Sony’s licensing scheme was an attempt to suppress the competing Lagadec technology and thus constituted patent misuse.

The Federal Circuit disagreed, cautioning that the patent misuse doctrine has not been applied expansively in the past and that the legislative history of 35 U.S.C. §271(d) showed Congress’s intent to “cabin” the doctrine. The court held that an anti-competitive agreement between companies to suppress a given technology would not constitute misuse of a patent covering alternative technology being promoted by the companies. Thus, although the Philips-Sony agreement might be vulnerable to challenge under the antitrust laws, the court refused to characterize the agreement as misuse of the Raaymakers patents. Philips could still enforce its patents against Princo.

²³ 332 U.S. 392, 400-01 (1947).

²⁴ 343 U.S. 444, 448-89 (1952).

²⁵ 323 U.S. 386, 412-13 (1945).

²⁶ 548 F.3d 1004 (Fed. Cir. 2008).

²⁷ *Id.* at 1026.

²⁸ *Id.* (finding patent misuse remedies “instructive”).

²⁹ *Id.*

³⁰ No. 07-1386 (Fed. Cir. Aug. 30, 2010), available at <http://www.ca9.uscourts.gov/images/stories/opinions-orders/07-1386.pdf>.



Future Patent Misuse Remedies: Applying *Qualcomm* and *Paice* to *Princo*

Despite the Federal Circuit's decision in *Princo*, one cannot help but speculate as to the appropriate remedy if patent misuse had been found.

Could the court have enforced the standard misuse remedy (*i.e.*, a royalty-free, compulsory license to the world) in the wake of *Qualcomm*? If not, and the court narrowly tailored its remedy, what would it be? Would the court limit unenforceability to products that used the Orange Book standard, or to those that used any patent within the pool? Could Sony still enforce the Lagadec patent following an unenforceability decision in *Princo*?

Qualcomm reminds us that patent misuse only renders the patent unenforceable "until the misuse is purged; it does not, of itself, invalidate

the patent."³¹ What would constitute "purge" in the *Princo* case? Did the misuse inhere in the inclusion of the Lagadec patent, or in a competing standard's failure to emerge? If the latter, willingness to independently license the Lagadec patent would certainly not "dissipate" the effect of misuse. But what would?

Could the court have "re-priced" the existing package based on consideration of the effects of a hypothetical competing standard? Such a remedy would not be without supporting precedent. In *Paice LLC v. Toyota Motor Corp.*, the Federal Circuit itself approved a court-ordered, ongoing licensing fee—a compulsory license—as a remedy for patent infringement.³² According to the Federal Circuit, the lower court could allow the parties to determine a reasonable royalty (as in *Besser*), and if the parties could not reach agreement, it could make the determination itself.

This recognition of a district

court's inherent power to fashion a compulsory license in the infringement context would appear to apply equally to a case of patent misuse. Accordingly, if misuse was found to have occurred in the *Princo* case, the lower court could have relied on the holdings in *Qualcomm* and *Paice* to order a reduced-rate compulsory license available to all manufacturers of products meeting the Orange Book standard.

Because the Federal Circuit dismissed *Princo*'s patent misuse claims, the court did not examine the possible remedies that may be available upon a finding of misuse. And because the court does not appear to be historically predisposed toward findings of patent misuse, it is unclear when it will have another opportunity to do so. Nevertheless, practitioners should be aware of the Federal Circuit's recent endorsement of court-imposed compulsory licenses in other contexts, and should be ready to request (or counter) such a remedy in future misuse cases.

³¹ 548 F.3d at 1025.

³² 504 F.3d 1293, 1315 (Fed. Cir. 2007) (holding that district court could, in absence of party agreement, "step in to assess a reasonable royalty in light of the ongoing infringement," but must provide reasons for its rate); *Id.* at 1316 ("District courts have considerable discretion in crafting equitable remedies, and in a limited number of cases, as here, imposition of an ongoing royalty may be appropriate. Nonetheless, calling a compulsory license an 'ongoing royalty' does not make it any less a compulsory license.") (J. Rader, concurring).

To Mark, Or Not To Mark

By
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“Patented” - everyone has seen the word. It appears on cardboard protectors around our morning cup of coffee, and in the manuals for our televisions. It is “marking.” There are benefits and risks for marking “Patented” on products. A recent Federal Circuit decision clarifies some of the risks. *Forest Group, Inc. v. Bon Tool Co.*, No. 2009-1044, 2009 WL 5064353 (Fed.Cir. Dec. 28, 2009).

One of the benefits that comes from marking products as “Patented” relates to past infringement damages. Although patent owners often ascribe prestige value to a U.S. Patent, the value lies in excluding others from practicing the patent claims. Those who practice the claims of a valid U.S. Patent without a license infringe that patent. If successfully sued, the infringer is generally liable for past infringement damages, and/or the infringer may be enjoined from future infringement.

A successful patent owner can collect infringement damages extending six years prior to the complaint filing date. 35 U.S.C. Sections 284 and 286. However, to collect for six years of past damages the infringer must have notice of infringement that also begins at least six years prior. Actual notice to the infringer is certainly sufficient. However, patent owners may not know of every infringement. Or, they may not want to provide notice

to a suspected infringer because the owner is not prepared to bring an infringement action. Providing infringement notice may expose the patent owner to declaratory judgment jurisdiction.

The marking provision of the Patent Act provides a solution to some of these problems. With proper “marking,” U.S. Patent owners can effectively serve notice of their patent rights to all competitors, allowing the patent owner to collect up to six years of past damages. Under the U.S. Patent Act: “Patentees, and persons making, offering for sale, or selling within the United States any patented article for or under them, or importing any patented article into the United States, may give notice to the public that the same is patented, either by fixing thereon the word ‘patent’ or the abbreviation ‘pat.’ together with the number of the patent, or when, from the character of the article, this cannot be done, by fixing to it, or to the package wherein one or more of them is contained, a label containing a like notice.” 35 U.S.C. Section 287(a).

Thus, by simply affixing the word “Patented” or “Pat.” with a corresponding U.S. Patent number, the patent owner can service notice to all competitors who might make, offer for sale, sell, or import a product that infringes on the owner’s U.S. Patent.

There are financial penalties for intentionally marking products as “Patented” if the products are not actually covered by the patent claims, or the patent is invalid, or the patent has expired. Recognizing that the mere presence of the word “Patented” on a product could chill competition, Congress included a penalty provision for falsely-marking a product as “Patented.” Under the statute: “Whoever marks upon, or affixes to, or uses in advertising in connection with any unpatented article the word ‘patent’ or any word or number importing the same is patented, for the purpose of deceiving the public;” ... “Shall be fined not more than \$500 for every such offense.” 35 U.S.C. Section 292.

Until recently, many district courts considering the penalty for false marking interpreted the Patent Act as requiring a \$500 fine for a single decision to falsely-mark. Under that interpretation, even with thousands of falsely-marked products, if there was only a single decision to falsely apply a patent number to the products, the maximum penalty was limited to \$500.

Some courts recognized that a \$500 maximum fine for a single marking decision would eviscerate the statute and adopted a time-based approach to falsemarking. Under such an approach, the penalty might be applied for each day, week or month that falsemarking occurred. Although these time-based approaches resulted in somewhat larger penalties, they were not uniformly applied.

Under the *Forest Group* holding, a patent owner’s potential financial penalties for false marking are not limited to \$500 for a single decision. A penalty must be calculated on a per falsely-marked article basis. Forest Group owned a U.S. Patent on a feature used in construction

False marking now has a potential for increased penalties, calculated on a per article basis.

stilts. Forest Group sold its own construction stilts and marked those stilts with that U.S. Patent number. Bon Tool had been purchasing construction stilts from a licensed supplier, but when Bon Tool stopped purchasing from that licensed supplier and started purchasing from an unlicensed supplier, Forest Group sued for patent infringement.

As typically happens in a patent case, there was a claim construction hearing and order. In that claim construction order, the district court interpreted the asserted claims to require a particular feature. That feature was not present in either the accused stilt products or in the Forest Group stilt products. As mentioned, Forest Group had marked their own construction stilts with the asserted patent number.

After learning that its own construction stilts did not practice the asserted patent, Forest Group placed a new construction stilt order, but those stilts continued to list the asserted patent number. The district court determined that by placing a new order after learning that the asserted patent did not cover the construction stilts, and failing to effectively remove the asserted patent number from the construction stilts in that new order, Forest Group had engaged in a single incident of false marking. The district court assessed a \$500 fine against Forest Group for false marking. Bon Tool appealed that decision.

In holding that the current false marking statute of the Patent Act sets a \$500 maximum fine on a *per article basis*, the Federal Circuit in *Forest Group* looked at the history of the false marking statute. Before a 1952 change, the false marking statute instead required a \$100 minimum penalty. Courts interpreting that previous statute had determined that if the \$100 minimum fine was calculated on a per article basis, with many falsely-marked articles, the penalty could be inequitable, particularly for products with modest value. The 1st Circuit in *London* concluded “[i]t can hardly have been the intent of Congress that penalties should accumulate as fast as a printing press or stamping machine might operate.” *London v. Everett H. Dunbar Corp.*, 179 F. 506, 508 (1st Cir. 1910). Accordingly, under the prior statute, “the continuous false marking of multiple articles should constitute a single offense subject to a distinct penalty.” However, although Congress changed the falsemarking statute in 1952 from a minimum \$100 penalty to a maximum \$500 penalty, many courts continued to apply the earlier reasoning from the *London* holding, applying the penalty on a per marking decision basis, instead of a per article basis.

In reversing and remanding, the Federal Circuit in *Forest Group* noted the differences and changes in the statutory language and also the minimal deterrent effect that a single \$500 penalty for false marking might have if there was only a single marking decision, but multiple articles. Under the proper analysis, the Federal Circuit in *Forest Group* held that “Section 292 clearly requires a per article fine.” However, the Federal Circuit also noted that “[b]y allowing a range of penalties, the statute provides district courts the discretion to strike a balance



between encouraging enforcement of an important public policy and imposing disproportionately large penalties for small, inexpensive items produced in large quantities. In the case of inexpensive mass-produced articles, a court has the discretion to determine that a fraction of a penny per article is a proper penalty.”

So, false marking now has a potential for increased penalties, calculated on a per article basis. However, the

false marking statute continues to require intent to falsely-mark by the patent owner. So long as the patent owner has established and maintains a goodfaith basis for marking, the risk of a false marking penalty should remain very low. However, the patent owner must remain diligent with respect to patent expiration dates, and any lapse due to non-payment of maintenance fees. Similarly, marking as patent pending could

implicate false marking penalties if the underlying patent application never issues as a patent and is abandoned, while the patent pending marking remains on the product.

The background of the image is a dark grey gradient. A horizontal band across the middle features a light blue-grey grid pattern, resembling a wireframe or a stylized architectural structure. The text is centered within this band.

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