



U.S. Supreme Court Hears Oral Argument in *Bilski v. Kappos*

On Monday, November 9, 2009, the U.S. Supreme Court heard oral arguments in the long anticipated case, *Bilski v. Kappos*. Central to the case is whether a process not tied to a particular machine or that does not transform matter from one physical state to another would be eligible for patent protection (the “machine-or-transformation test”). The patent statute, 35 U.S.C. §101, does not recite this limitation, and instead states that “any new and useful process” is eligible for patent protection.

The Supreme Court last weighed in what defines patent-eligible subject matter almost thirty years ago, long before the Internet and computer software technology developed into what they are today. The court’s decision in *Bilski* has potentially far-reaching effects for pending patent applications and issued patents that claim processes, such as computer software and business method patents. This is one of the most closely watched patent-

related cases the Supreme Court has decided in decades.

Bilski v. Kappos concerns a patent application directed to a method for hedging risk in a commodities trade. None of the patent claims involve a computer or other machine. The Patent Office rejected the claims on the grounds that the invention was not eligible for patent protection under 35 U.S.C. §101. *Bilski* appealed to the Board of Patent Appeals and Interferences, and after the Examiner’s rejection was upheld, to the Court of Appeals for the Federal Circuit. Struggling to determine what the term “process” in §101 means and how to determine whether applicants’ claim 1 is a “new and useful process” under the statute, the Court of Appeals for the Federal Circuit held that a “claim process is surely patent-eligible under §101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing” *In re Bilski*, 545 F.3d 943, 954, 88 U.S.P.Q. 2d 1385, 1391 (Fed. Cir. 2008) (*en banc*). Since *Bilski*’s claims did not satisfy points (1) and (2), the CAFC upheld the Examiner’s rejection. The Supreme Court granted *certiorari*.

During oral arguments, some Justices expressed concern over the ability to craft a new rule that, pursuant to prior Supreme Court decisions (the “Judicial exceptions”), would preclude abstract ideas and laws of nature from being patented, while still be sufficiently broad to protect as of yet unknown future innovations and technologies.

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Throughout the oral arguments, the Justices cited examples in common themes relating to subject matter that is eligible for patent protection. For example, Justice Kennedy questioned whether patents should be limited to exclude insurance policies. Other examples were raised, including training horses, protecting Morse Code, patenting an alphabet and patenting managing consumption risk, which related to the facts in *Bilski v. Kappos*. Petitioners consistently set forth the argument that technology in its broadest sense means “the application of knowledge as opposed to general knowledge,” and those processes applying knowledge are patentable.

Most of the Justices, including Justice Ginsburg, Justice Stevens, Justice Scalia, Justice Sotomayor and Chief Justice Roberts seemed averse to allowing patents for methods and processes that involve “just human activity, as opposed to some machines, substance, or other apparatus.” In response, the Petitioners identified previously patented subject matter that was strictly directed to human activity, including surgical methods performed by a doctor and methods of teaching. In virtually each response to the Justices questions, the Petitioners argued that so long as a process is new and non-obvious, and does not fall under one of the narrow judicial exceptions, such as described above, the process should be entitled to patent protection.

Another theme that resounded through the arguments related to computer software technology. The Justices questioned the view that an unpatentable business method, *per se*, that is not tied to a machine or does not involve a transformation of a substance should somehow become eligible for patent protection if merely performed on a

computer. For example, Chief Justice Roberts, citing to a footnote at the end of the Respondent’s brief, concluded that by merely reciting a machine, such as “using a typewriter” to type out an unpatentable process would enable the process to become patentable was questionable. Other justices struggled with similar issues, wondering how merely involving the use of a machine should somehow transform non-patentable subject matter to patentable subject matter.

Notably, the Respondent did not argue that use of the computer should be insufficient to transform unpatentable subject matter (*e.g.*, a business method) to patentable subject matter, when a processor executes steps that are programmed into the computer to perform a particular task. Although, when challenged, the Respondent did concede that performing steps by merely using a calculator is probably insufficient to pass the machine-or-transformation test. Citing to CAFC precedent, the Respondent noted that such difficult questions are left unsettled and are more appropriately left for another day.

The Court is apparently struggling to develop a new and effective rule that limits patent protection for some subject matter, but is not so strict as to stifle future innovations. At one point, and perhaps the most indicative of why the Supreme Court decided to hear *Bilski* in the first place, Justice Sotomayor stated “So help us with a test that doesn't go to the extreme the Federal Circuit did, which is to preclude any other items, something we held open explicitly in two other cases, so we would have to backtrack and say now we are ruling that we were wrong[.]” In another quote, Justice Sotomayor stated “No ruling in this case is going to change *State Street*.” This suggests that the Court

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Don't Dismiss Patent Damages Reform So Lightly

In what appears to be a perennial debate, legislative patent reform is now presented for consideration of the general public through mainstream media outlets. A recent editorial by Robert C. Pozen, published in the November 16, 2009 New York Times, argues that disputes over revisions to the method for calculating infringement damages is preventing other needed reforms from moving forward. Pozen states "Congress shouldn't make the best the enemy of the good." Notwithstanding, the implications of current damages reform proposals are worthy of exploration.

The patent act sets a reasonable royalty as minimum damages for infringement. This has been interpreted as what would have been negotiated between the parties in an arms length transaction-before the lawsuit. The royalty is some percentage of revenue derived from the patented article. A critical factor in calculating the royalty is the base of the royalty, or the pool of funds to which the percentage is applied. A long-accepted "entire market value" rule is one of the *Georgia-Pacific* factors to be considered in determining a reasonable royalty, named for the seminal case on the issue. Applied to the hypothetical negotiation, the "entire market value" rule considers that the royalty base would include not just the patented article, but the value of the products with which the patented article would be sold ("convoy goods").

Often, however, the patented advance may be only a small component of a larger system. Take for example the intermittent windshield wiper. This invention was the subject of a decades-long patent dispute with Ford Motor Company (among others), and was dramatized in the 2008 film "Flash of Genius". The patented advance was a unique control mechanism that permitted automatic periodic cycling of the windshield wipers (U.S. Pat. No. 4,339,698).

Under the "entire market value" rule, the base of

royalties was not just that of the control electronics. The royalty base of the wiper system including those electronics would have been larger, ultimately the royalty base being the sale of automobiles having the intermittent wiper system.

At issue in the patent reform legislation is called apportionment of damages, which would limit the application of the entire market value rule and permit recovery of a royalty based upon the value of the product that is attributable to the patentable advance. At first glance, the apportionment issue may seem like a red herring. After all, couldn't the value of the patented contribution be reflected in the percentage of the royalty, irrespective of the base? A 50% royalty on such a groundbreaking control system may be reasonable. A windshield wiper system with intermittent controls may merit a 10% royalty, because while impressive for its time, one could provide a functional windshield wiper without them. On the other hand, how much value does the buyer of a \$25,000 automobile place on the control of its windshield wipers? In theory, the hypothetical, arms length negotiation would presumably set the royalty rate to account for this.

In practice, however, the amount of damages is an issue for a lay jury to decide. Experience shows that human nature restrains a jury from awarding what, in the abstract, might be seen as a miniscule royalty rate, even though the result is adequate compensation for the infringement when applied to a sufficiently large base. For example, a generous 50% royalty on a \$10 controller (\$5) becomes a 10% royalty on a \$50 wiper assembly, but a 0.02% royalty on a \$25,000 car. When a court forces the jury to assign a royalty rate using the "entire market value" of the cars sold as the base, 0.02% may seem inadequate. However, when distilled down to the advance provided by the invention, it is identical to a 50% royalty on the

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inventive controller.

The proposed reform would make it more difficult for the patentee to capture the “entire market value” as the royalty base for damages calculation. Both House and Senate versions of the Patent Reform Act of 2009 state:

Upon a showing to the satisfaction of the court that the claimed invention's specific contribution over the prior art is the predominant basis for market demand for an infringing product or process, damages may be based upon the entire market value of that infringing product or process.

In one recent case, the Court has already taken action to limit the royalty base. Circuit Judge Randal R. Rader of the Court of Appeals for the Federal Circuit (CAFC), sitting by designation in *Cornell University v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. Apr. 24, 2009) ruled on post-verdict motions to reduce a jury award of \$184 MM to \$53.5 MM, citing that the royalty base was improperly linked to products beyond the scope of the patented invention. The opinion resists the migration of the “entire market value”

rule from a tool to calculate lost profits, including “convoy goods”, into the realm of reasonable royalty determination by expanding the reasonable royalty base to include products not covered by the patent.

CAFC Chief Judge Paul R. Michel has spoken against similar legislative proposals. In a letter to Congress concerning a 2007 version of the measure, Judge Michel wrote “under current caselaw, the burden of apportioning the base for reasonable royalties falls on the infringer, while the burden for application of the Entire Market Value Rule falls on the patentee. In most cases, apportionment is not an issue requiring analysis.” He also said “the present bills would require a new, kind of macroeconomic analysis that would be extremely costly and time consuming, far more so that the current application of well-settled apportionment law.”

Therefore, the debate over patent damages reform continues to be fought on many fronts, including the halls of Congress, of the Courts, and even perhaps in the editorial pages.

by David J. Torrente, Associate

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Oral Argument in *Bilski*

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does intend to modify the Federal Circuit's machine-or-transformation test in some way, but not go so far as to overrule *State Street*. However, questions posed from the bench at oral argument are, at best, an unreliable tool to derive any indication of how the Court will rule.

by Joel J. Felber, Senior Associate