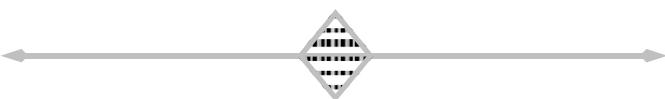


CAFC *en banc* Decision in *In Re Bilski* Restates Scope of Patentable Subject Matter

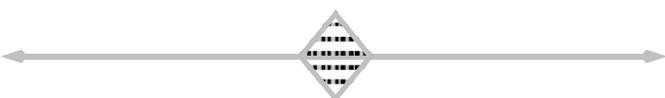
On October 30, 2008, the *en banc* Court of Appeals for the Federal Circuit (“CAFC”) rendered its long-awaited decision concerning “business method patents” in *In re Bilski* (“Bilski”). By a vote of 9 to 3, the CAFC affirmed the Patent Office Board of Patent Appeals and Interferences that rejected patent application claims for being directed to subject matter that is not patentable under 35 U.S.C. § 101 (“§ 101”). The CAFC cited to U. S. Supreme Court precedent for determining whether a process is patentable 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.” The CAFC applied the “machine-or-transformation” test defined by the Supreme Court, and the appellant’s claims were held to fail that test.

The CAFC decision in *Bilski* is largely viewed as to limit the kinds of subject matter that can be claimed in U.S. patents. The court abandoned previous standards that test for subject matter that is eligible for patent protection. First, the Court examined the *Freeman-Walter-Abele* test, which determines whether a claim recites an algorithm [within the meaning of *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972)], and then whether that algorithm is “applied in any manner to physical elements or process steps.” In *Bilski*, the Court held that test to be “inadequate”, and concluded that a claim that fails that test may “nonetheless be patent-eligible.” The CAFC held that “even a claim that recites ‘physical steps’ but neither recites a particular machine or apparatus, nor transforms any article into a different state or thing, is not drawn to patent-eligible subject matter. Conversely, a claim that purportedly lacks any ‘physical steps’ but is still tied to a machine or achieves an eligible transformation passes muster under § 101.” Secondly, the Court examined a test for patent-eligible subject matter associated with the landmark *State Street* decision that determines whether the claimed invention produces a “useful, concrete, and tangible result.” In *Bilski*, the Court held that test, too, is insufficient and concluded “the machine-or-transformation test is the applicable test for patent-eligible subject matter.”

Noting that algorithms are unpatentable, *per se*, the CAFC cited to *Benson* for support that patent claims which preempt all uses of an algo-



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CAFC *en banc* Decision in *In Re Bilski*

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rithm are unpatentable. The CAFC concluded that claims preempting all uses of an algorithm, i.e., the “algorithm that has no uses other than those that are covered by the claims,” are “effectively drawn to the algorithm itself.” Alternatively, a process that “transforms a particular article to a specified different state or thing by applying a fundamental principle” does define patentable subject matter on the grounds provided the principle (i.e., the algorithm) can be used “to transform any other article, to transform the same article but in a manner not covered by the claim, or to do anything other than transform the specified article.” Accordingly, the Court adopted the “machine-or-transformation” test requiring that claims recite subject matter that “is tied to a particular machine or apparatus,” or “transforms a particular article into a different state or thing.”

Although some view the *Bilski* decision as signaling the end of business method patents and patents directed to software, it is at least questionable whether the CAFC decision in *Bilski* spells the end for such patents. For example, the Court noted that so long as a “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 preempt all uses of the principle.” Further, the Court left open 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.”

Moreover, the CAFC reiterated its position in *State Street* that business method claims have no “categorical exceptions” and are “subject to the same legal requirements for patentability as applied to any other process or method.” The Court

decided that when the machine-or-transformation test is met, a business method process recites subject matter that is patentable, at least under Section 101. Although the machine-or-transformation test may narrow the determination whether subject matter is eligible for patent protection, the decision does not appear to exclude inventors from enjoying patent protection for software-related inventions, including those that are drawn to business methods.

by Joel J. Felber, Senior Associate

No Willful Infringement In Avionics Litigation

In the latest patent skirmish between Honeywell International, Inc., and Universal Avionics Systems Corp., the District Court of Delaware granted Universal summary judgment of no willful infringement. *Honeywell, Int'l, et al., v. Universal Avionics Systems Corp, et al.*, C.A. No. 02-359-MPT(D. De., Nov. 12, 2008) An earlier CAFC decision in a case between the same parties and concerning the similar technology was reported in our Feb/Mar 2008 edition (available at www.Ostrolenk.com).

This case was on remand from the CAFC, which had vacated the court's earlier summary judgment of non-infringement due to an error in claim construction. Here the district court applied *In re Seagate*, 497 F.3d 1360 (Fed. Cir. 2007)(*en banc*) to defendant's motion for partial summary judgment that any infringement was not willful.

The court found that Universal's legitimate defenses to the infringement claims, vetted by the earlier summary judgment of non-infringement and trial judgment of invalidity of certain claims, only reversed on appeal, eliminated the possibility that they acted with an objectively reckless manner as required under *Seagate*. Summary Judgment motion granted.

by David J. Torrente, Associate

Supreme Court Unanimously Upholds Application of Patent Exhaustion Doctrine

On June 9, 2008, the U.S. Supreme Court unanimously reversed the Federal Circuit in a case narrowly construing the application of the patent exhaustion doctrine. *Quanta Computer, et al. v. LG Electronics, Inc.* 128 S. Ct. 2109; 170 L. Ed. 2d 996; 2008 U.S. LEXIS 4702; 76 U.S.L.W. 4375; 86 U.S.P.Q.2D (BNA) 1673. The Federal Circuit decision created a great deal of uncertainty among patent practitioners by calling into question when a patent holder may sue for patent infringement against downstream purchasers following the sale of patented subject-matter to an initial purchaser. *LG Elecs., Inc. v. Bizcom Elecs., Inc.*, 453 F.3d 1364 (Fed. Cir. 2006), *rehearing, en banc, denied* by 2006 U.S. App. LEXIS 23211 (Fed. Cir. 2006).

Background

LG electronics purchased a computer technology patent portfolio, including three patents with apparatus and method claims teaching novel data retrieval, coordination, and management technology. LG licensed these patents to Intel Corporation, the license including microprocessors and chipsets practicing the patents. The agreement expressly stated that no license was granted “to any third party for the combination by a third party of Licensed Products...with items, components, or the like acquired...from sources other than a party” to the agreement. The license also acknowledged that “the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products.” As part of the license, Intel sent letters to its customers warning of this license exclusion, intending to prevent any Intel customer from combining licensed Intel microprocessor chips with non-Intel components.

Several subcontractors for large national computer manufacturers, including defendant

Quanta, purchased the Intel microprocessor chips and used them to build computers for the national manufacturers pursuant to Intel’s specifications. LG brought suit against these subcontractors and other Intel post-license customers on the basis that they violated the “condition” of Intel’s license by not paying patent royalties to LG for the downstream sale. Quanta responded to the suit by arguing that because there was no reasonable use for the chips other than to be integrated into devices such as Quanta’s products, it is counterintuitive, and more important, contrary to the patent exhaustion doctrine, to claim patent infringement against downstream purchasers who purchased the Intel product for its sole purported use.¹ LG claimed that the exhaustion doctrine was inapplicable, as LG did not “sell” their patented-technology to Intel, but merely created a “manufacturers’ license” wherein they could still control their product as it traveled through the supply chain.

The California district court granted Quanta partial summary judgment on its patent exhaustion defense. The district judge, however, found the exhaustion doctrine applied to LG’s apparatus claims, but not its method claims. LG appealed, arguing that the doctrine was inapplicable to both apparatus and method claims. The Federal Circuit agreed and reversed the district court. Judge Mayer, writing for a unanimous panel that included Chief Judge Michel and Judge Newman, reasoned that while an unconditional sale may warrant application of the exhaustion doctrine, LG’s license was distinguishable as the sale was expressly conditional. In other words, by the express terms of the license, LG had successfully reserved its right to seek subsequent royalties from downstream purchasers. After a rehearing, *en banc*, was denied, Quanta appealed to the Court to stem what

Supreme Court Applies Patent Exhaustion Doctrine

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it argued was the steady erosion of the patent exhaustion doctrine by the Federal Circuit resulting in unwarranted expansion of the patent monopoly.

Reversal

Writing for the unanimous Court, Justice Thomas rejected the Federal Circuit's reasoning and reminded the Court of Appeals that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress science and useful arts.'" Utilizing 150+ years of Supreme Court jurisprudence, the Court further explained that "[t]he longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item. [] '[W]here one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article.'"

Applying this straight-forward precedent to the Federal Circuit's opinion, the Court found that "the Intel products constitute a material part of the patented invention and all but completely practice the patent [and as such] the incomplete article substantially embodies the patent because the only step necessary to practice the patent is the application of common processes or the addition of standard parts." The Court rejected LG's "manufacturers' license" argument, explaining that "[n]othing in the License Agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts." Moreover, providing notice of LG's patent rights was not a condition precedent to Intel's ability to sell the microprocessors and chipsets to secondary purchasers, nor was the

secondary purchasers' consent to the terms of Intel's license as a condition of purchase. In other words, Intel's downstream sales were, as a matter of law, authorized sales triggering application of the exhaustion doctrine.²

The Court also rejected the Federal Circuit's reasoning that the patent exhaustion doctrine does not apply to method claims, holding that "nothing in this Court's approach to patent exhaustion supports LG's argument that method patents cannot be exhausted." The Court explained that "[e]liminating exhaustion for method patents would seriously undermine the exhaustion doctrine. Patentees seeking to avoid patent exhaustion would simply draft their patent claims to describe a method rather than an apparatus."

Practical Application

Patent licensors, when drafting agreements to sell licensed products to unlicensed manufacturers, should also strongly consider including express terms that provide the patentee with contract damages where exhaustion may operate to eliminate patent damages.

Patent litigators seeking to enforce or escape patent claims (both apparatus and method) against downstream purchasers should now focus on whether and how patented components are a "material part of the patented invention" as well as whether and how components that do not so completely practice the invention (or have both infringing and non-infringing uses) are still reasonably subject to infringement claims subsequent to first sale.

¹ Quanta purchased microprocessors and chipsets from Intel. Quanta thereafter manufactured computers using Intel parts in combination with non-Intel memory and buses in ways that practiced the LG patents. Quanta did not modify the Intel parts and followed Intel's own specifications to incorporate the parts into the computers.

² The Court did note, however, "that the authorized nature of the sale to Quanta does not necessarily limit [LG]'s other contract rights. [LG]'s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages."