Bilski & the Economy; Intellectual Property's Changing Landscape

A Roundtable Discussion • February 2009

Moderator:

HON. WILLIAM F. McDONALD (RET.)

Mediator/Arbitrator, JAMS

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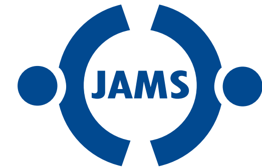

PANELISTS:

- **Jennifer Kinsbruner Bush, Esq.**
  Principal, Fish & Richardson P.C.
- **Vern D. Schooley, Esq.**
  Partner, Fulwider Patton LLP
- **John Sganga, Esq.**
  Partner, Knobbe Martens Olson & Bear LLP

McDONALD: Good morning all, and welcome to our roundtable discussion.

The economic realities of today are weighing deep in the minds of the Fortune 500 and the legal industry that guides and serves them. With no end to these financial doldrums in sight, the Intellectual Property community, principals and practitioners alike, are beginning to consider the cost of patent prosecution and litigation in light of *In re Bilski* and shrinking legal budgets. Indeed, a recent survey indicates the filing of lawsuits involving intellectual properties has fallen dramatically. *Bilski* notwithstanding, the financial crisis will certainly affect the efficacy of settlement agreements and their ability to stick.

Vern, those of us familiar with the "machine-or-transformation" test from the 1960s see some rather difficult days ahead for *Bilski*. What types of challenges might cause the Supreme Court to address this decision?

SCHOOLEY: The short answer is that the prospects for [certiorari] ("cert.") review of *Bilski* are slim.

If a petition for cert. is filed, the Supreme Court may invite the Solicitor General to file an amicus brief. The Solicitor General has significant credibility with the Supreme Court, and its position could be critical in whether the Supreme Court decides to take cert. The Solicitor General could take the position that the Supreme Court should grant cert. to review *State Street* and the United States Patent and Trademark Office's proposed "technological arts" test that was rejected by the United States Court of Appeals for the Federal Circuit. On the other hand, the Solicitor General is more likely to take the position that the United States Patent and Trademark Office and the lower courts should be given time to implement and work on the machine-or-transformation test. However, this is all merely speculation on the Solicitor General's position.

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> ***– Judge William McDonald***

Another factor is how threatened software companies are about *Bilski*. Because the United States Court of Appeals for the Federal Circuit left open the question of "whether or when recitation of a computer suffices to tie a process claim to a particular machine," technology companies may want clarity and certainty on this issue. And the *Bilski* opinion recognized that the Supreme Court may want to modify this test for emerging technologies. A slew of amicus briefs from the technology industry could influence the Supreme Court's decision on cert. However, *Bilski* admitted that the claims were not limited to a computer, so this may not be the best vehicle to present that issue.

Indeed, during our panel discussion a petition for cert. was filed arguing that the machine-or-transformation test was an abrupt departure from the settled law. The Petitioner argues that the Supreme Court has declined the opportunity to adopt that test in the past and that the proper test is: "anything under the sun that is made by man" except "laws of nature, natural phenomena, and abstract ideas." *Chakrabarty*. I still believe there are only modest prospects of cert. being granted.

McDONALD: John, Jennifer, any comments?

SGANGA: I think that the attractive aspect for the Supreme Court may be to take the cue from Judge Newman's dissent in *Bilski* and make a broadside attack on business method patents generally. The Supreme Court has been trimming back on patent owner's rights

JENNIFER KINSBRUNER BUSH, ESQ.

Principal, Fish & Richardson P.C.

www.fr.com

FISH & RICHARDSON

in general recently, and in *eBay* did not show any real sympathy for the plaintiff in many business method patent cases, namely the "non-practicing" patentee, or "troll." However, *Bilski* may just not be the right case for the Supreme Court to take on that issue since it did not present patent claims with anything that was arguably a "machine." In some ways the legal test may not have been that significant to the outcome in *Bilski*; since the claims were just too abstract. It may make more sense for some of the issues in the machine-or-transformation test to be worked out a bit more in subsequent cases, and for the Supreme Court to take it up in another case in which the facts of the case more squarely present that issue.

BUSH: The Board of Patent Appeals and Interferences has issued several recent decisions invalidating claims in light of *Bilski*, such as *In re Halligan* and *Ex parte Cornea-Hasegan*. Those decisions illustrate the need to work out how the machine-or-transformation test applies to a variety of claims, including software claims and claims involving a "general purpose computer," as opposed to a computer that is specifically programmed to perform a claimed method. As John says, the Supreme Court may decide that the claims in *Bilski* do not present the best vehicle for addressing that test, and may prefer to allow the test to be elaborated further in the Federal Circuit before addressing it (if necessary) in a subsequent case.

McDONALD: John and Jennifer, I agree the claims in *Bilski* were about as abstract as anything I have seen. Those of us who had claims to computer programs allowed by the PTO back in the 1960s, before they were officially sanctioned, did so by tying them to a particular machine or apparatus or to the transformation of a particular article into a different state, e.g., bauxite into aluminum. Because of memory and other limitations, most computers in those days were specific purpose. This is not the case today. I suspect this may have an effect on the cost of patent prosecution by requiring very specific details in the specification and possibly in the claims as to hardware and firmware. This will require more attorney time interfacing with the inventor and in writing the specification and claims. John, have you given some thought to *Bilski*'s impact on the cost of related patent litigation?

SGANGA: I think that in a handful of patent infringement cases you will see a lot of litigation over issues that may have been treated as "low percentage plays" a few years ago, but the marginal cost to argue these defenses will likely be low. A serious defense that a patent is invalid under section 101 for lack of statutory or "patent eligible" subject matter has generally been rare. I think that the trend with the *Bilski* case, the *In re Comiskey* case, and others are certainly going to raise awareness about the potential for section 101 invalidity defenses to succeed. In fact, a patent on a real estate investment vehicle was just ruled invalid on summary judgment based on a *Bilski* defense on January 22nd, in a case in the Central District of California, *Fort Properties v. American Master Lease* (SA CV07-365 AG).

Of course, the technology at issue and the claim scope will have to fit with the defense, but there is a lot of litigation over business method patents. These cases could be ripe for pursuing this defense through appeal to the Federal Circuit. The *Bilski* decision certainly left room for advocacy regarding the application of the "machine" prong of the standard, i.e., is it enough to simply mention a computer in the claim to obtain patentable subject matter? The same is true in *Comiskey*, where the Federal Circuit remanded to allow consideration of some dependent claims which added limitations regarding Internet access.

Certainly the Federal Circuit seems to have greater interest in the section 101 issue, since they raised it *sua sponte* in *Comiskey*. That almost seems like an invitation to litigants to focus on this defense. Also, whenever you have as many dissenting opinions as those cases generated, savvy litigants become more willing to try creative arguments in the hope that, with the right panel at the Federal Circuit, they will be able to get a positive result.

This will be particularly true for some larger companies that are "serial" defendants in patent cases, and often the targets of "patent trolls." I would expect that those companies will be willing to litigate the section 101 issues more aggressively since a victory in one case could influence other cases favorably. In other words, the economics of the case at hand may not justify the cost of the litigation, but the long term benefits could.

> With respect to *Bilski's* impact on the cost of litigation, I think that at least in the short term, we may see an upswing in summary judgment rulings finding claims unpatentable on section 101 grounds. ***– Jennifer Bush, Esq.***

That said, the section 101 issue is usually not one that entails large amounts of discovery. It may well lend itself to a summary judgment motion by a defendant, as it did in the *Fort Properties* case. So I don't expect *Bilski* to engen-

der the kind of overhaul to patent litigation that *Markman* brought about, where we routinely have separate proceedings on claim construction, regardless of the patented technology.

McDONALD: Jennifer, any comments?

BUSH: I expect that due to the renewed interest in section 101 and lack of clarity about the application of the machine-or-transformation test, section 101 defenses will become fairly routine in a variety of cases, and not just cases involving business methods. For instance, I expect this defense will be routinely raised in cases involving medical methods and methods performed using software. I also expect that, taking their cue from recent Board opinions applying *Bilski*, litigants will argue that the machine-or-transformation test also applies to method of manufacture claims.

With respect to *Bilski*'s impact on the cost of litigation, I think that at least in the short term, we may see an upswing in summary judgment rulings finding claims unpatentable on section 101 grounds. As John mentions, in certain instances there will be little or no discovery necessary to resolve such summary judgment motions, making this issue particularly amenable to resolution on summary judgment in appropriate cases. This may significantly decrease the cost of litigation in cases where the defense applies.

McDONALD: That brings me to the next question, shifting gears a bit, but relating to the economic uncertainties. Traditionally, a settlement agreement would not be reduced to judgment unless there had been a default in compliance by a party. If a party defaults and files bankruptcy, the other party to the settlement will be far down the creditor list. Considering the financial health of many industries, is this an incentive to have a judgment entered initially with an agreement to file a notice of satisfaction when the terms are satisfied? Jennifer, have you seen this play out recently?

BUSH: In this financial climate, the risk that a settling defendant will default on payments and file bankruptcy is a real concern. I do not believe that most defendants would be willing to have a judgment entered initially; in many instances part of the incentive to settle is to prevent entry of an adverse judgment. However, we have seen some cases (not patent cases) in which the settlement agreement included a signed stipulated judgment for an amount greater than the settlement amount, to be held in escrow by the plaintiff and filed only in the event of a default on payments (for whatever reason). We have not had the opportunity to test any of these in bankruptcy court, though, because the defendants in those cases have not defaulted.

Given the expected increase in disputes involving the ownership of IP, midsize and smaller companies, even in bet-the-company disputes, will look more to mediation or binding arbitration.– ***Vern Schooley, Esq.***

McDONALD: John, Vern, how about you?

SGANGA: Another technique I have seen employed to give some certainty to the party receiving payment is to sequence the timing of the payment ahead of filing the dismissal papers with the court. Along with this you can make the obligations to dismiss the case and release all claims be contingent upon receiving payment. Having the court action still looming can be a strong incentive to make the payment. Of course, if the case has imminent court deadlines those will need to be addressed by a stipulation.

McDONALD: Any other impacts of present economic conditions? Are lump sum rather than running royalties gaining in favor? Are parties less willing to grant licenses and more likely to seek an agreement to cease and desist or an injunction? John or Jennifer?

SGANGA: Lump sum or "fully paid up" licenses are quite common as the template for the resolution of a patent infringement suit. While paying a running royalty may seem to defer costs into the future, and shift some risk to the patent owner if the sales diminish for some unexpected reason, defendants often prefer not to go that route for several reasons.

First, there is always some potential for a future dispute over whether royalties are owed on a new product that is introduced later. Second, the lump sum payment allows the defendant to have certainty as to its exposure. With the economy being what it is, there is another incentive in favor of the lump sum, which is to swallow the bitter pill now, at the same time earnings reports are dismal anyway.

The place where I see running royalties still is in the true collaborative development effort where a patentee brings new technology to the table, but usually not when there has been protracted litigation.

As the markets shrink, patentees that are litigating against direct competitors usually do want to try to force the defendant out of the market entirely. In light of the economic slow-

VERN D. SCHOOLEY, ESQ.

Partner, Fulwider Patton LLP

www.fulpat.com

FULWIDER • PATTON LLP
INTELLECTUAL PROPERTY LAW

JOHN SGANGA, ESQ.
Partner, Knobbe Martens Olson & Bear LLP
www.kmob.com

Knobbe Martens
INTELLECTUAL PROPERTY LAW

down, it is much more apparent now that a licensee could be taking sales directly from the patentee.

BUSH: My experience is that "fully paid up" licenses are more prevalent in certain industries, while in others the "running royalty" is the norm. Thus far, I have not seen any paradigm shifts prompted by the current financial crisis. I can imagine that some plaintiffs who would have traditionally favored running royalties may now favor a lump sum royalty due to their financial conditions, but I have not yet seen this occur in practice.

McDONALD; Vern, what do you think?

SCHOOLEY: John and Jennifer are right in recognizing that the economic impact has had an influence on settlements, placing the patent holders in a position where they demand greater upfront payments and seek higher running royalties to place the accused infringers at a great disadvantage in the marketplace. More patent holders are holding out for stipulated judgments or guarantees from deep pocket backers.

McDONALD: Have any of you noticed the financial crisis causing companies to reduce their R&D budgets which in turn is causing fewer patent applications to be filed?

BUSH: Currently, we are certainly seeing that some companies are cutting legal and R&D budgets, which would suggest a decrease in patent filings in the coming year or two. On the other hand, we are also seeing what appears to be an increase in individuals and companies selling patents in order to raise capital. The market for purchasing patents may fuel filings in certain instances.

All told, however, my own inclination is that there will be a decrease in patent filings in the short term, as patentees try to streamline their patent prosecution costs and focus on the applications of greatest strategic importance.

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> ***– John Sganga, Esq.***

SGANGA: Likewise, I see established companies cutting budgets, but not as much as you would expect in light of the amount of layoffs that are taking place. For startups, venture capital is harder to come by, and that could translate to fewer filings in the long run.

SCHOOLEY: I have noticed greater selectivity in filing by some of my larger clients, but substantial increases by some niche clients and individual inventors. I expect this trend to continue until the economy starts to turn.

McDONALD: One final question: Given the risks, expenses, and uncertainties in litigation, will the financial crisis encourage companies to resolve IP disputes by mediation or arbitration rather than litigation?

SCHOOLEY: With the economic downturn, IP disputes are on the rise. Competitors are seeking to gain advantages by imitating competitive products, and companies are downsizing and terminating engineers who tend to move on to the competition, taking their knowledge with them.

Given the expected increase in disputes involving the ownership of IP, midsize and smaller companies, even in bet-the-company disputes, will look more to mediation or binding arbitration. Executives overseeing the litigation will be weighing the advantages of mediation and will be more willing to commit the time and effort to seek a resolution which both parties might find acceptable.

On the other hand, where significant market share is involved, you can expect that clients seeking to benefit might commit even more funds to litigation in an effort to improve profits from the expected additional share.

SGANGA: I agree with Vern's comments. Certainly ADR continues to become more widely used in general as courts incorporate mediations into their regular pre-trial procedures. I think the economic climate will create a dichotomy here. Certain higher-stakes cases will become less likely to settle since a litigation payoff may be the only hope of generating income. At the same time, more common cases will benefit even more from ADR as parties try to minimize litigation costs.

BUSH: On the last point, my sense is that in many cases, settlement will be a more attractive option given the current financial climate. This may involve increased use of mediation. Like John, I expect that ADR may be used more frequently as parties try to manage their litigation costs. ●

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