Bilski and the case for IP audits

The Supreme Court's recent decision in the *Bilski* case should encourage US patent owners to undertake a systematic audit of their portfolios. Failure to do so could end up being an expensive mistake

By **Edward Van Gieson**

On 28th June 2010, the US Supreme Court issued its landmark holding in *Bilski v Kappos*, regarding the patentability of process claims under 35 USC § 101. Bilski's patent was directed to a business method and was held invalid as an attempt to patent an abstract idea, falling foul of the doctrine that patentable subject matter does not include laws of nature, physical phenomena or abstract ideas.

Bilski raises many interesting issues for performing an IP audit of patent portfolios, particularly for those portfolios that include software patents or business method patents. Additionally, *Bilski* is relevant to patents in other fields, such as medical diagnostics.

An IP audit is a systematic review of the IP assets owned or used by a business. An IP audit may be a regularly scheduled IP audit or may be performed as needed for various business reasons, such as reviewing a patent portfolio for venture-backed investments, mergers or acquisitions. The goals of an IP audit may vary, but will generally include reviewing the IP portfolio to analyse risks, minimise costs and determine options to increase IP value. Additionally, an IP audit may include a review of a company's related IP practices and policies.

Continuing evolution

Bilski marks another chapter in the continuing evolution of the courts' interpretation of patentable subject matter in the software and business method arenas. A typical patent portfolio may include patents with a range of issue dates such that individual issued patents in the portfolio may not necessarily have been crafted in a manner consistent with the current state of the law. Companies having patents relating to business methods, software and medical diagnostics should consider the implications of *Bilski* when performing an IP audit.

In *Bilski*, the Supreme Court rejected the Federal Circuit's earlier holding that the machine or transformation (MOT) test is the only test for determining whether a process claim is patentable subject matter. The Supreme Court did not define any specific tests besides the MOT test. Moreover, the *Bilski* court criticised the useful, tangible and concrete (UCT) test, as articulated in *State Street Bank & Trust Co v Signature Financial Group*.

For the purposes of an IP audit after *Bilski*, relative risks can be assigned based on whether there is a reasonable argument that a claim satisfies the MOT test – that is, it is tied to a particular machine or transforms an article from one thing or state to another. Additionally, the Supreme Court's earlier 35 USC § 101 jurisprudence of *Benson*, *Flook* and *Diehr* (cited in *Bilski*) can be used as guidance for whether the process claims may also fall foul of the doctrine against patenting laws of nature, physical phenomena or abstract ideas. Such an approach was taken in the briefing of the US International Trade Commission (ITC) case, *In the Matter of Certain Machine Vision Systems, Software and Products Containing Same*. On 2nd July 2010 MVTeC Software GmbH filed an action with the ITC to have Cognex's patents invalidated in light of the *Bilski* ruling on the argument that such claims do not satisfy the MOT test and are

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directed towards algorithms that are simply abstract ideas and thus are not patentable subject matter.

Relative risk

For the purposes of an IP audit, an understanding of relative risks as simple as high/low risks of invalidity under *Bilski* is sufficient to generate a useful strategy to minimise risks and increase patent portfolio value. Of course, further guidance in the future from the courts on how to apply *Bilski* will be useful in performing an IP audit and might permit classification into three or more risk regimes (eg, high/medium/low).

One aspect of performing an IP audit is analysing the affect of *Bilski* on past damages for a patent portfolio. Referring to Figure 1, US patent law treats process claims differently from other types of claim in assessing past damages (ie, damages for infringement prior to the filing of a lawsuit) (see *State Contracting & Eng'r Corp v Condotte Am Inc*). A patent owner can collect past damages for up to six years prior to filing a patent lawsuit patent. For process claims, there are no special requirements to pursue past damages. However, for claims directed to patented articles (eg, computer-readable medium claims, apparatus claims and system claims), the patent owner can collect past damages only if it has either marked any products covered by the patent with the patent number or provided notice of potential infringement prior to the lawsuit.

It is not always practical to send notice letters, which in any case raises the risk of infringers filing declaratory judgment actions. Marking can also be a significant burden on a patent owner to confirm that the patent is in force and that at least one claim covers the product that is marked, particularly in light of potential liability for improper marking under the false marking statute.

Process claims are an extraordinarily useful means to obtain past damages without having to mark products or send notice letters. Thus, it is important in an IP audit to consider whether there is a high risk of invalidity for the process claims. Losing rights to past damages is a risk that needs to be considered in an audit. In some fact patterns the risks of losing past damages will be greater than others.

Consider as an example a patent portfolio that includes a set of patents that issued in 2000 under the UCT test. We'll assume that the patent term in this example extends to 2017 and that the patents have both process and non-process claims. No marking or notice is required to collect past damages for up to six years if only the process claims of a particular patent are litigated. Assume that the patent portfolio will not be litigated in the near future, but might be asserted sometime in the future before the patents come to the end of their term. Thus, there is a hidden damages problem.

What happens if the patents are asserted in four, five or six years and, in the worst case, all of the process claims are invalidated under *Bilski*? If there has been no marking or notice letters, then the patent owner would be unable to collect past damages. Moreover, in this example, the patents will be close to end of term when the lawsuit is filed such that there may be comparatively little in the way of post-filing damages. In this example, failure to perform an IP audit could have disastrous downstream implications for the patent holder with respect to collecting past damages.

Invalidity dangers

In an IP audit, a patent portfolio can be examined to determine whether there is a

Figure 1. ***Bilski's* effects on past damages**

high risk of invalidity of the process claims. An additional check can be performed to determine whether the non-process claims are still potentially valuable in terms of their claim scope. For example, the non-process claims can be compared against a company's products, a competitor's products or the industry standards. If there is a significant risk of losing valuable rights to past damages, a marking programme can be implemented. However, if this is done, it is important to comply with the requirements of the marking case law to avoid liability for false marking. Alternatively, a company may consider sending notice letters to potential infringers for the specific patent that is at risk under *Bilski*.

Another task for an IP audit is to confirm that all patent opinions of invalidity that a company may be relying on are consistent with the current law. Companies sometimes request opinions of counsel regarding the non-infringement or invalidity of selected patents in an effort to avoid violating the rights of other patent owners. Opinions are also sometimes obtained to address the concerns of customers or beneficiaries of indemnity agreements. If an invalidity opinion is based in any part on the premise that some of the patent claims are directed towards unpatentable subject matter under 35 USC §101, it is important to review such an opinion to confirm that it is consistent with the Supreme Court's decision in *Bilski*.

An IP audit may be useful for certain types of culling considerations. Culling can generally include any decision to reduce the size of a patent portfolio by selling, donating or abandoning patents (to avoid maintenance fees). How does one take *Bilski* into account in a culling decision? One way is to use it to generate an appropriate weighting factor to weed out patents that are otherwise marginal to a company's interests. For example, a culling decision might include some factor related to the general scope of the patent, some factor related to whether the patent covers a company's own products or the competitor's products, and some other factor related to litigation strength. If a patent is marginal on other grounds, a high risk factor under *Bilski* might be used as an additional factor that favours culling the patent.

Patent correction

An IP audit can also include analysing the patent portfolio to determine whether patent correction procedures can be used to improve it. US patent law includes patent correction procedures that can be utilised to amend the claims of issued patents. However, these correction procedures must be used with great care to preserve existing patent value, particularly when there is an uncertain risk as to whether a particular claim would be found invalid in a future litigation.

Patent correction may be necessary in situations in which a particular patent has process claims with a high risk of invalidity under *Bilski* and there are no other pending or issued patents to provide a backup. Additionally, an individual patent may have no other non-process claims of a broad scope. Consider, for example, a patent intended to cover an optimised use of a standard and that broad process claims were crafted to catch infringers. Also consider that either there are no other types of claim that are broad enough to be useful in litigation. In this example, the patent owner may find a high risk under *Bilski* to be unacceptable and choose to correct the patent.

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Reissue is normally the preferred option to correct a patent for which there is a risk of invalidity under *Bilski*. The reissue statute is specifically designed to correct a wide variety of errors that render a claim invalid or otherwise result in the claim having an incorrect scope. Under 35 USC § 251, a patent owner may file a request for a patent to be reissued to correct errors related to the patent being "wholly or partly inoperative or invalid ... [including] the patentee claiming more or less than he had a right to claim in the patent". During reissue proceedings, all of the claims are examined, including the original claims and any claims that are amended or added during reissue. Note that a broadening reissue must be filed within two years of the issue date of the patent.

Re-examination

Re-examination was not intended to permit direct correction of 35 USC § 101 errors, but some types of patent correction may be performed during re-examination in the context of narrowing the original claims or filing new (narrower) claim sets. Under 35 USC § 302, a patent owner may file a request for its patent to be re-examined. A request for re-examination requires identifying prior art references that raise a substantial new question of patentability for at least one claim. As a result, this procedure typically increases the costs and risks compared with reissue proceedings. Moreover, the patent office can also deny a request for re-examination if the patentee is unable to make a significant enough showing identifying how the prior art raises a substantial new question of patentability.

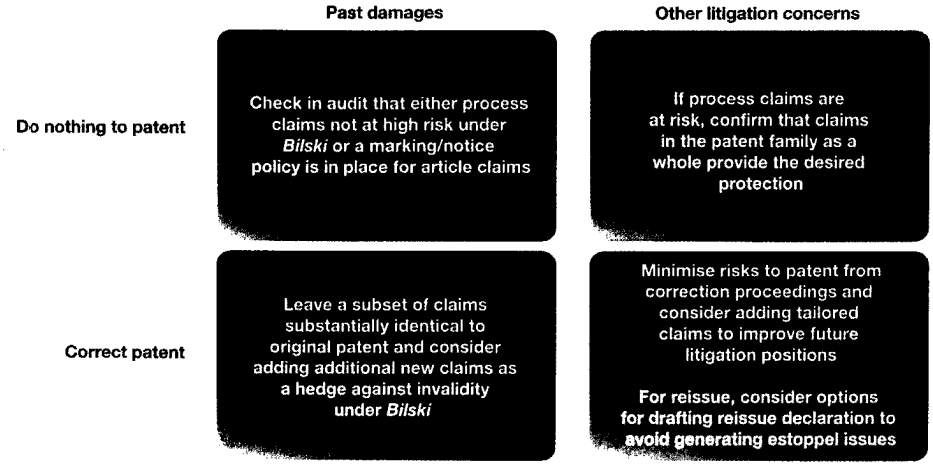
Furthermore, re-examination does not directly address 35 USC § 101 validity issues. There is also anecdotal evidence that some USPTO examiners may object to amendments that are *de minimis* attempts to address only 35 USC § 101 patentable subject-matter issues without any significant material narrowing of the claims. However, if a re-examination is granted, the patent owner may file amendments that narrow individual issued claims or add new claims, which are narrower than the broadest issued claims. The narrowing may be performed in a manner that materially narrows the claims and that also provides additional grounds to address *Bilski* issues, such as by adding a claim limitation that ties the process to a specific machine or apparatus in either an original claim or a new dependent claim.

There are extremely rare fact patterns where re-examination might be considered instead of reissue to address 35 USC § 101 issues. For example, suppose that a patent family includes two issued patents, a parent patent and a divisional patent that issued at a later date. We will also assume that the process claims in each issued patent have similar *Bilski* weaknesses.

Suppose that the best prior art came up in the divisional patent and that the parent patent has claims that are possibly overbroad. In theory, the patent owner could use reissue to cleanse prior art in the parent patent and also address *Bilski* issues.

However, the patent owner could also consider re-examination of the parent patent for the patent office to consider the prior art that came to light in the other patent. During re-examination, additional narrower claim sets could be added as a hedge against invalidity under *Bilski*. Re-examination proceedings typically have a shorter pendency than reissue proceedings. Additionally, no declarations have to be

Figure 2. **Correcting a patent using USPTO procedures**



filed during re-examination proceedings and no admissions of error have to be made. Moreover, the patent owner can select only a subset of the issued claims for re-examination. In this example, re-examination of the parent patent might be favoured over reissue, particularly if the patent owner plans to assert both patents sometime in the near future.

Correction decisions

Figure 2 illustrates some of the decisions that a patent holder faces in regard to whether to correct a patent using the USPTO's correction procedures. Referring to the upper left-hand box, for some fact patterns there is a low risk of losing past damages, either due to the process claims being at low risk or because there is a marking or notice policy for broad article claims. Referring to the upper right-hand box, correction may also be disfavoured if the strength of the portfolio as a whole, including any pending continuation or divisional applications, is sufficient. In an IP audit, the potential downside risk can be analysed under worst-case scenarios, such as losing all claims not falling within the MOT test. If the claim scope in the patent family is still broad enough to catch likely infringers under such a worst-case scenario, then no corrective action may need to be taken to preserve the future value of the patent portfolio. Additionally, an IP audit may consider the option of reshaping other pending applications to reduce the worst case risk of losing specific issued process claims under *Bilski*.

The bottom left-hand box illustrates past damage considerations if patent correction is used. Both re-examination and reissue proceedings can be expected to last for several years. The patent owner should be concerned about not unnecessarily forfeiting rights to past patent damages. Past damages are forfeited unless at least one of the claims that emerges from reissue or re-examination proceedings is substantially identical in scope to an original issued claim.

What the patent owner typically wants if correction procedures are used is a balanced strategy that preserves rights to past damages while also hedging risks of invalidity of all process claims under *Bilski*. One strategy a patent owner may want to consider for re-examination is requesting re-examination of only a subset of the issued claims. For example, if there are 20 issued claims, the patent owner could request re-examination of only one claim and then either amend that claim or add new dependent claims to reduce the chance of invalidity under *Bilski*. The USPTO normally limits its analysis to those specific claims for which re-examination is requested, along with any additional new claims added during re-examination.

Reissue strategies

During reissue proceedings the USPTO is supposed to review and examine all of the claims. However, as a practical matter the USPTO tends to focus most of its resources on examining those specific claims that are being corrected, amended or added during the reissue procedures. Original (unamended) claims are often (but not always) allowed in a first office action during reissue. Thus, during reissue one strategy is to leave a large number of the original claims unamended in the original reissue application filing. In turn, new claims can be added that are crafted to have a lower risk under *Bilski*.

Correction proceedings can also be used in a strategic manner to strengthen a patent, such as by adding tailored claims directed to a competitor's products

Referring to the bottom right-hand box of Figure 2, there are also other litigation concerns to be considered if correction procedures are used. Correction proceedings can also be used in a strategic manner to strengthen a patent, such as by adding tailored claims directed to a competitor's products. Correction proceedings do expose a patent to risks, some of which can be minimised, such as by carefully complying with patent office disclosure requirements to reduce inequitable conduct risks. Additionally, if a reissue application is filed, careful consideration should be given to the reissue declaration to avoid various kinds of estoppel, particularly for past damages.

The patent office requires the filing of a reissue declaration identifying at least one error under 35 USC § 251 for which correction is being requested. Under USPTO guidelines, it is improper merely to add dependent claims in a reissue application as a hedge against potential invalidity without also identifying an error in the patent that satisfies the requirements of 35 USC § 251.

If the reissue declaration states that the error is that the claim is invalid under 35 USC § 101 (in light of *Bilski*), then the patent owner has effectively conceded that the issued claim is invalid for the purposes of asserting the claim in litigation and for assessing past damages. If reissue proceedings drag on for many years, then the potential estoppel implications of the reissue declaration can be a particularly important consideration.

However, the USPTO does not require every error in the patent to be described in the reissue declaration. The patentee needs to describe only one legitimate error under 35 USC § 251 for which correction is being sought. One approach that the patent owner may want to consider is whether the reissue declaration can legitimately be crafted to describe an error for a different claim in the patent from the claim that is at risk under *Bilski*. For example, the patent owner might consider whether the patent includes a dependent claim that is inoperative in that the claim language has typographical errors, grammatical errors, poorly worded language or errors in antecedent basis that render the claim invalid under 35 USC § 112. The patent owner can describe this error in the reissue declaration and then amend other claims or add other claims as a hedge against invalidity under *Bilski*.

Broadening protection

An IP audit may also consider whether any patents that issued within the past two years are candidates for a broadened reissue. In the context of *Bilski*, one issue is whether patent owners obtained less protection than they should have for patents that issued in the interim period between the Federal Circuit's earlier holding and the Supreme Court's final ruling. During the interim period the USPTO often forced the patentee to add specific claim limitations which may no longer be necessary.

It is thus conceivable that a patent that issued during the interim period may not provide all of the protection that a patent owner needs. For example, suppose that a patent application started out with broad process claims drafted to be compliant with the UCT test. During the interim period the USPTO would have forced the patent owner to add additional limitations to meet the MOT test. As a result, the issued process

claims may recite a limitation, such as a limitation for a particular apparatus, which narrows the claims more than desired.

A broadened reissue is one way to address such a situation, since MOT is no longer an exclusive test. However, a reissue application that broadens the claims by removing even a single limitation must be filed within two years of the issue date of the patent. Additionally, the patentee is not permitted to recapture subject matter surrendered in the original prosecution without also materially narrowing the reissue claims. If a broadened reissue application is filed, the patentee may want to consider carefully drafting the broadened reissue claims to fall exactly within the safe harbours described by the patent office in order to minimise the chances of receiving a recapture rejection.

Audit now!

In summary, the Supreme Court's holding in *Bilski* raises important issues for performing an IP audit. The ambiguity in the decision is certainly less than ideal and the patent community hopes that the Federal Circuit will provide greater clarity in the coming years on how to apply *Bilski* in different fact patterns. Nevertheless, it is important to recognise that there is already enough guidance in the Supreme Court's decision to perform an IP audit to reduce downstream risks, reduce costs and address other patent valuation concerns. ***iam***

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