

How strong is first inventor defense?

Prior-user rights provisions are riddled with qualifications meant to limit its applicability.

BY [FREDERIC M. MEEKER](#)

AND [GARY D. FEDOROCHKO](#)

SPECIAL TO THE NATIONAL LAW JOURNAL

STATE STREET BANK & Trust Co. v. Signature Financial Group Inc.¹, coupled with several previous cases in the Federal Circuit, opened the door for service companies that employ information technology in their business to protect their inventions with business method patents. Recent cases thrust traditional service companies into the forefront of the intellectual property field.²

Companies that have been slow to react and adapt to these changes in the law and marketplace have fallen behind the power curve. Many of these companies are starting to receive demand letters from their competitors and have few or no patents to use offensively or in cross-licensing negotiations. Some of these companies are being driven out of lucrative business opportunities by more aggressive competitors that have adapted more quickly to the realities in this new business environment.

The rapid changes in the law left some companies feeling that current patent law was insufficient to protect their interests adequately. These companies turned to Congress for relief from their more aggressive competitors. For example, service companies that decided to become active in the patent field were finding that the patent law prevented them from filing patent applications on business methods that had been used for more than the one-year grace period allowed by the patent laws. When a company maintains a "business method" invention as a trade secret and employs the invention in commerce for more than one year, it is forever barred from receiving a patent on the invention, even when the invention is used in secret.

The problem faced by established service companies was compounded by another aspect of the patent law. Namely, the secret use of a business method by one company does not prevent another company that newly discovers the

method from obtaining a patent on the same invention. This is due to the public-policy objective of encouraging inventors to disclose their inventions to the public in return for a limited monopoly in the form of a patent. As explained by the U.S. Court of Appeals for the Federal Circuit in *WL Gore & Associates Inc. v. Garlock Inc.*:

"Early public disclosure is a linchpin of the patent system. As between a prior inventor [who does not disclose] and a later inventor who promptly files a patent application...the law favors the latter."³

During the negotiations over the act, parties could not agree on what 'a method of doing business' means.

These competing patent policy goals have created the situation in which new competitors entering various service industries are obtaining patents on business methods and techniques once held as trade secrets by more established companies. Before the *State Street* decision, most companies believed that they could not obtain patents directed to these business methods. Thus, the interplay between the Federal Circuit's changing the scope of patent protection in *State Street*, coupled with the patent policy reasoning and rules expressed in *WL Gore*, may well result in businesses long employing a business method being prohibited from seeking patent protection in their own right while being enjoined by newcomers seeking patents on business methods they have long employed.

Although some of the more aggressive and tech-savvy service companies have embraced the newly created ability to protect their business with patents, other companies fear having patents applied to their industries. In particular, some businesses in the financial services industries sought to rectify this perceived inequity by lobbying Congress for the passage of legislation to address their concerns.

The solution adopted by Congress was the introduction of a new affirmative defense to patent infringement by creating certain limited prior user rights. The American Bar Association Section of Intellectual Property Law

has long opposed the introduction of prior-user rights into the patent laws for the obvious policy reason that prior-user rights encourage inventors to keep their inventions secret, thus stifling innovation. Despite this long-standing opposition to prior user rights, last summer, the ABA Section of Intellectual Property Law qualified its opposition to prior-user rights so as to favor legislation granting limited prior-user rights, provided such legislation was part of a comprehensive patent reform legislative package.⁴

With these and other changes, all significant opposition in Congress disappeared, and the American Inventors Protection Act of 1999 was enacted. It included the prior-user rights provisions that proponents of the legislation termed the "first inventor defense." The First Inventor Defense Act of 1999 added a new § 273 to the statute.⁵ It is a defense to an act of infringement if the patent claims asserted involve a method of doing or conducting business and the claimed method was actually reduced to practice more than a year before the effective filing date (including any claim to priority) and commercially used in the United States before the filing date.⁶

As a practical matter, during negotiations over the legislation, the parties could not agree on what constituted "a method of doing or conducting business." A definition was not provided in the legislation, and it was left to the courts to decide what types of inventions would fall within the prior-user rights provisions. Subsequent commentators who have reviewed the statute and legislative history cannot even agree on whether the statute only includes methods, as it states on its face, or whether it also includes machines that implement the methods.

For example, the statute says that the defense extends to the disposition of a useful end product produced by the patented method to the extent that such rights would have been exhausted had sale or disposition been by the patent owner. However, the extension of the defense to end products may not apply to product claims of the patentee relating to the end products and also may not apply to product-by-process claims. Given the sharp divisions within Congress on this issue, as might be expected,

the legislative history is not a model of clarity. In any event, much debate remains as to what types of patent claims fall under these provisions. For example, is a method of doing business somehow different from a method of conducting business? In the final analysis, it will be up to the courts to determine these questions.

Limitations of the defense

Also, assuming that the courts reach a definitive interpretation of what is and what is not a "method of doing business," the prior-user rights provisions are riddled with qualifications and limitations designed to restrict severely the applicability of the defense. Some of those limitations and qualifications include:

- The defense may not be asserted by anyone who derived the method from the patentee or from people in privity with the patentee.

- The defense is not a general license to all claims of the patent; it applies only to the subject matter, covered by method-of-doing-or-conducting-business claims, that was actually reduced to practice more than a year before the effective filing date.

- The defense must be shown by clear and convincing evidence.

- A person who abandons commercial use of the subject matter may not rely on any activities performed before the date of abandonment for actions taken after the date of abandonment.

- The defense may only be asserted by a person who performed the acts necessary to establish the defense, except when the rights to assert the defense are transferred with the good-faith assignment or transfer of the entire enterprise or line of business to which the defense relates, but only for use at sites where the subject matter was in use before the later of the effective filing date of the patent or the date of assignment or transfer.

- A patent is not deemed to be invalid solely because a prior-user-rights defense has been raised or established.

- The defense extends to variations in quantity or volume of the claimed subject matter, but not to improvements that infringe additional claimed subject matter of the patent.

- Activities performed by a nonprofit research laboratory, university, research center or hospital may be considered to be "commercially used" except that the use may be asserted as a defense only for continued use by and in the laboratory or nonprofit entity, and may not be asserted as a defense with respect to any subsequent commercialization or use outside the laboratory or nonprofit entity.

Patent term guarantee

The average pendency of applications in the U.S. Patent and Trademark Office has risen to about two years. Average pendency times have increased even more for patents in the areas of software, e-commerce and the Internet, due to the meteoric rise in patent filings in these areas. This problem is likely to get far worse as Congress and the current administration continue to divert user fees from the PTO to fund other programs.

For applications filed since June 8, 1995, the expiration of the patent term is measured from

The limits on the prior-user rights provisions, and the longer term of patents, require more aggressive protection of IP.

the patent's filing date rather than from its issue date. Thus, before Congress' passage of the new legislation, snags in the PTO effectively shortened the term of a patent by delaying issuance of the patent for several years. Recognizing this inequity, Congress included a provision in the new legislation called the patent term guarantee.

The patent term guarantee provides deadlines by which the PTO must act on an application. Otherwise, a patent issuing from the application can be extended one day for each day of administrative delay caused by the PTO. The specific guarantees include examination of an application within 14 months of filing, taking action within four months of a response or appeal, taking action within four months after a decision on appeal for an application with allowable subject matter and issuance of a patent within four months after the issue fee has been paid. Further, the PTO guarantees no more than a three-year application pendency not including any continued examination of the application. Any delay caused by the applicant, including requests for extension of time, will reduce the period for extension by the delay caused by applicant.⁷

When considered with the provisional rights⁸ available for published applications—also enacted in the new patent legislation—a patent that experiences administrative delays could have an effective term significantly longer than 20 years. This provides further incentive to file patent applications, particularly in technology sectors such as software, e-commerce, Internet and business method inventions, for which the average application pendency is known to be long.

Patents in the service industry have become a necessary ingredient of a successful business. Many service companies have begun patent audit programs before launching new products, in which new product offerings are reviewed for patentable subject matter before public release of the product. Subcontractors building Web pages are being asked to assign any inventions created during the project back to the contracting company. Employees involved in nontraditional occupations are being asked to sign obligations to assign patents in their employment agreements.

Even service companies with well-developed product offerings are protecting improvements and recent modifications to these products with patents. Recent patent law changes have created some relief for established companies with existing business methods that have been kept as trade secrets. However, the limitations of the prior-user rights provisions, together with the longer term enacted as part of the patent term guarantee, require service companies to be more aggressive in protecting their intellectual property.

(1) 149 F.3d 1368 (Fed. Cir. 1998) (holding that claims related to a computer-implemented data processing system for managing financial services were for a patentable invention).

(2) See, e.g., *AT&T Corp. v. Excel Communications Inc.*, 172 F.3d 1352 (Fed. Cir. 1999).

(3) *W.L. Gore & Associates Inc. v. Garlock Inc.*, 721 F.2d 1540, 1550 (Fed. Cir. 1983).

(4) See Resolution 1999 AR-R101-1A, adopted by the ABA's Section of Intellectual Property Law.

(5) 35 U.S.C. 273.

(6) The First Inventor Defense took effect on the date of enactment (Nov. 29, 1999), but did not apply to any pending infringement action or any prior adjudication of infringement.

(7) The Patent Term Guarantee took effect on the date of enactment of the legislation, Nov. 29, 1999.

(8) Provisional rights allow a patent holder to collect a reasonable royalty for acts of infringement on a patent that occurred before the issuance of the patent, beginning with the date of publication of the application. However, to be entitled to provisional rights, the claims in the patent must be substantially identical to the claims published in the application. Provisional rights will be available for all patents issuing from applications filed on or after Nov. 29 of this year and published before issuance, and all applications pending on Nov. 29 that were published voluntarily by the patent applicant. **NLI**