

Supreme Court may decide fate of business method patents (July 30, 2009)

Debate over ability to patent ideas and business methods could come to a conclusion in the Bilski case this fall.

Banks have a stake—in both sides of the case, potentially

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The best ideas are common property. Seneca (5 BC - 65 AD)

This fall the United States Supreme Court will take up a variant of an age-old query: Can you own an idea?

The case, *Bilski v. Doll*, will decide the legal question of whether an “idea”—in this case a method for predicting and hedging risk in commodities markets—is properly patentable under United States law. By agreeing to grant certiorari in *Bilski*, the Court has positioned itself to decide the fate of a relatively new species of intellectual property—the business method patent (BMP). (“Certiorari,” literally, “to make sure,” in Latin, is like an appeal, but one which the higher court is not required to take for decision.)

The Court’s decision in this case could impact fees that banks pay for use of certain business methods and approaches, especially in the technology area. Some background will put the importance of this issue for banking into perspective.

Patents evolve towards methodologies

American patent law finds its genesis in the Constitution. Article I, section 8, grants to Congress the power to “promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.” Congress acted quickly, and the first domestic statute protecting inventions was signed into law by George Washington in 1790. The current version of the patent code is a direct descendant of that original enactment, providing protection to “whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof…”

While it was agreed by the Founding Fathers that protecting the legitimate fruits of an inventor’s labors (at least for a period of time) is good public policy, what sorts of inventions should be protected?

When most people think of patentable inventions, tangible creations, such as Eli Whitney's cotton gin or Alexander Graham Bell's telephone, immediately come to mind. Generally these are tangible items or machines that did not exist prior to the research, development, and experimentation of these scientists.

But what about less-tangible ideas?

When the most-recent version of the federal patent statute was enacted in 1952, much of what we take for granted in terms of current technology was unheard of. Computers and the software needed to run them were far in the future. Part of the current uncertainty in how to treat intangible inventions is the fact that Congress has not brought the patent laws up to date to address the rapid advancements in technology that have occurred over the past 50 years. As a result, it has been left up to the United States Patent and Trademark Office and, ultimately, the courts, to determine what is and is not patentable.

Patent boundaries shift and expand

Despite the absence of guidance from Congress, certain trends emerged. Prior to 1998, computer programs, mathematical formulas, algorithms, and business methods were not considered patentable subject matter. The Patent Office and courts repeated the mantra that business methods were "per se unpatentable" and that the "business method exception" was a barrier for many computer, data processing, and e-commerce companies to protecting their rights. Typically, then, these codes and methods of doing business were guarded and treated as trade secrets.

That is not to say that the concept of what is patentable has remained static.

By the 1980's the Patent Office and the courts were pushed to gradually expand the scope of patentable subject matter. In 1980, for example, the Supreme Court in *Diamond v. Chakrabarty* remarked that the intent of the patent law was to "include anything under the sun that is made by man." This definition (based on a 1952 report to Congress) opened the door to the prospect of obtaining patents for the hitherto-unpatentable electronic and computerized innovations being developed and marketed.

This apparent leap in scope was narrowed a year later by the Supreme Court in *Diamond v. Diehr*, which held that a process for curing rubber with a computerized numerical controller could not be patented. The *Diehr* case outlined three categories of inventions that remained unpatentable: "laws of nature, natural phenomena and abstract ideas."

Neither *Chakrabarty* nor *Diehr* specifically take up the issue of business method patents, however. In fact, until 1998, it was thought that BMPs would not fulfill the three basic requirements of a patent of being novel, useful, and non-obvious.

BMPs emerge

The situation changed in 1998, when the United States Court of Appeals for the Federal Circuit took up the issue of whether a patent could be granted for a BMP. The case, *State Street Bank and Trust v. Signature*, affirmed a patent for

“Data Processing System for Hub and Spoke Financial Services Configuration” — a BMP. The State Street court found that “the transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces “a useful, concrete and tangible result” — a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.”

State Street provided the spark that ignited the explosion in software and business method patents—it has been cited as authority for patenting any BMP that produces a “useful, concrete and tangible result.”

The State Street case has also spawned a similar explosion in patent litigation. Since 1998, the number of BMPs and patent litigation associated with such claims has soared. From 1999 to 2001 the number of BMPs filed with the United States Patent and Trademark offices increased threefold and patent litigation related to these patents is currently at an all time high.

Enter Bilski

Everything you’ve read up until now may change this fall.

Tentatively scheduled for argument in late 2009, the Supreme Court’s review of the Federal Circuit’s en banc decision in Bilski will necessarily require the Court to wrestle with the fundamental question of whether and to what extent a BMP may be protected by patent. (“En banc” refers to decisions where an entire court takes part, versus smaller panels used when hearing most appeals.)

The Federal Circuit in Bilski rejected patent claims involving a method of hedging risks in commodities trading, concluding that the applicable test for determining patent eligibility is the “machine-or-transformation test” — a process qualifies for patent protection only if:

(1) it is implemented with a particular machine, that is, one specifically devised and adapted to carry out the process in a way that is not concededly conventional and is not trivial; or else

(2) it transforms an article from one thing or state to another.

In granting review, the U.S. Supreme Court will take up two issues:

(1) whether the Federal Circuit erred by holding that a “process” must be tied to a particular machine or apparatus, or transform a particular article into a different state or thing to be eligible for patenting, and

(2) whether the Federal Circuit's "machine-or-transformation" test for patent eligibility contradicts congressional intent that patents protect "method[s] of doing or conducting business." 35 U.S.C. § 273.

Effects and implications of future decision

Ultimately, a resolution of the thorny issue of whether BMPs are patentable may well be up to Congress.

It has been over 50 years since the Patent Act was last updated by Congress and, depending on the reaction to the outcome of *Bilski*, Congress may be compelled to act and provide a legislative fix if the Supreme Court's decision creates or perpetuates a situation that is deemed to be untenable.

Does that mean that patent reform likely? Given that Congress has shown little interest or willingness to step in for over half a century, it would take a significant and immediate threat to protecting intellectual property in the United States to motivate Congress to take up the issue. *Bilski* could provide that motivation. Either way, the Supreme Court's decision in *Bilski* is likely to have a very significant and lasting impact on patent eligibility, potentially reshaping the rules surrounding patent eligibility well into the 21st century. We must stay tuned.

A natural question is, what impact will this have on contractual relationships that banks have with holders of business method patents currently? Some banks are paying patent holders licensing fees for various technologies and business approaches. But there are also financial companies that hold such patents and receive such fees.

It is too early to say whether *Bilski* will result in the invalidation of BMPs.

Although there are many financial institutions that are rooting for this result, like any good fight, there are two very engaged camps with a vested interest in the outcome. Those financial institutions and companies that own BMPs are looking for the court to support the *State Street* ruling and bring closure to whether business methods and software are patentable subject matters. However, there are many who have suffered during the emergence of BMPs and are currently licensees of business methods that are essential aspects of their business. Check 21 processing is a good example. For these members of this camp, an invalidation of BMPs might signal the end of licensing and fees associated with business methods that the Court declares to be invalid. Once again, we must stay tuned. BJ

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EDITOR'S QUESTION TO READERS:

What impact would a decisive ruling in *Bilski* for or against business method patents have on your bank?
Comment below.