

May 2008 / Special Alert

A legal update from Dechert's Intellectual Property Group

Federal Circuit Court Hears Oral Argument in *In re Bilski*: Which Financial Methods Are Eligible for Patenting?

In a packed courtroom in Washington, D.C., the U.S. Court of Appeals for the Federal Circuit engaged in a spirited dialogue and heard a wide range of views on May 8 regarding the types of business methods and other processes that should—or should not—be eligible for patent protection. The case (In re Bilski, Appeal No. 2007-1130) specifically concerns a rejected application to patent a method for hedging fixed price commodities, but the court's decision can impact patentability of a broader range of subjects, including such diverse matters as financial and other business methods, computer software, and medical diagnostics and procedures. A decision likely will be handed down by the second half of 2008; in the interim, the May 8 hearing sheds light on what factors might be key to the court's ruling. From the tenor of the discussion at the oral argument, it seems likely that the Federal Circuit will uphold State Street and the patentability of business methods in general, but will articulate new or modified tests, particularly for methods comprising solely human actions or mental processes and are not machine implemented.

State of the Law on Patentability of Business Methods Prior to *Bilski*

Section 101 of the Patent Law sets out the categories of "patentable subject matter," meaning those inventions that are eligible for patentability: "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." 35 U.S.C. § 101. In addition, in a series of decisions interpreting this statute, the U.S. Su-

preme Court established three categories of inventions that are excluded from patentability: laws of nature, natural phenomena, and abstract ideas. See, e.g., *Diamond v. Diehr*, 450 U.S. 175 (1981).

The current debate in the Federal Circuit Court centers on the appropriate scope and interpretation of the term "any new and useful process." Nearly ten years ago, in its 1998 *State Street* decision, the Federal Circuit rejected the widely-held belief that a method of doing business should always be viewed as abstract and therefore not eligible for patenting. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998). The *State Street* case involved a hub-and-spoke investment method that was implemented by a computer. The Federal Circuit concluded that a method of doing business should not be viewed as abstract per se; rather the patentability of the method or process would depend on whether it produces a "useful, concrete and tangible result." *Id.* See also *AT&T Corp. v. Excel Commc'ns, Inc.*, 172 F.3d 1352 (Fed. Cir. 1999).

Following *State Street*, the number of business method patents applied for and issued, particularly in the financial services industry, increased exponentially. Examples include patents for automated trading systems, investment structures and methods, hedging methods, methods of managing risk, financial structures for reducing taxes, and structured financial products.

This dramatic increase in business method patenting reflected a fundamental change in the way that many financial services companies protected their intellectual property. Critical internal processes and systems, traditionally maintained as confidential trade secrets, now were the subject of public patent applications and, in many cases, issued patents. At the same time, financial services companies faced new challenges: on the one hand, facing patent suits that threatened their right to conduct certain key business processes and, on the other hand, determining whether to enforce or license their own patents to competing financial companies.

Meanwhile, the U.S. Patent & Trademark Office, the agency responsible for enforcing these standards in examining applications for patents, faced the challenge of applying the new standard for patent eligibility articulated in *State Street*. In general, the test could be readily applied where an invention involved data that was transformed by a machine, as in the case of a trading system or hedging method that manipulates a complicated set of data and uses complex calculations. In such circumstances, applying the *State Street* test, a method would be found patentable where it “constituted a practical application of an abstract idea (a mathematical algorithm, formula, or calculation) because it produced ‘a useful, concrete and tangible result.’” *In re Alappat*, 33 F.3d 1526 (Fed. Cir. 1994). On the other hand, applying the *State Street* test to inventions comprising claims that could be performed entirely by mental process or human action, without the use of any machine or technology, proved relatively more difficult. The Patent Office published a set of guidelines specifically directed to the application of the *State Street* test to non-machine implemented processes (published at http://www.uspto.gov/web/offices/pac/dapp/opla/precnotice/guidelines101_20051026.pdf). But, in practice, the USPTO examiners and Patent Office’s Board of Appeals and Interferences (BPAI), the administrative body that reviews patentability decisions, appeared to have greater difficulty readily or uniformly applying the “concrete” and “tangible” criteria where the method did not involve a machine or other technology, or any transformation of matter. *Ex parte Lundgren*, 76 USPQ2d 1385 (Bd. Pat. App. & Int. 2005).

At the same time, there are indications that at least some justices on the U. S. Supreme Court viewed the *State Street* test as overbroad or possibly even wrong. In 2006, in a closely watched case that involved a medical diagnostic method performed by a doctor without the use of any medical tool or technology, *Lab. Corp. of Am. Holdings v. Metabolite Lab., Inc.*, 548 U.S. 124 (2006), the Supreme Court came close to addressing the patentability of business methods. The Court never reached

the merits of the appeal, however, deciding instead to send the case back to the district court on a procedural ground. But in his dissent, Justice Breyer appeared to question the validity of the *State Street* test, noting that *State Street’s* “useful, concrete and tangible result” test had never been uttered or embraced by the Supreme Court, and expressing concern that the application of this tests would have resulted in finding patentability in situations that Justice Breyer deemed undeserving. Notably, Justices Stevens and Souter joined in the dissent, with Chief Justice Roberts taking no part in the opinion.

Against this background, the BPAI in late 2006 considered the Bilski invention, which involves a method for controlling risks in connection with commodity contracts.¹ In affirming the Patent Office examiner’s rejection of the Bilski claims as not comprising patentable subject matter under Section 101, the BPAI observed that, although the *State Street* test was not limited to machine-implemented methods, that case did involve a computer-implemented method. The BPAI concluded that the (1) *State Street* decision did not provide guidance whether the “useful, concrete and tangible” test applied to a process practiced entirely by human action and without any machine of technology and, (2) if the test is relevant to such inventions, the Federal Circuit had provided no guidance how it should be applied. See *Ex parte Bilski*, Appeal No. 2002-2257, 2006 WL 4080055 (B.P.A.I. September 26, 2006) (holding that “a ‘process’ under § 101 requires a transformation of

¹ Independent claim 1 of the Bilski application sets forth the method as:

1. A method for managing the consumption risk costs of a commodity sold by a commodity provider at a fixed price comprising the steps of:
 - (a) initiating a series of transactions between said commodity provider and consumers of said commodity wherein said consumers purchase said commodity at a fixed rate based upon historical averages, said fixed rate corresponding to a risk position of said consumer;
 - (b) identifying market participants for said commodity having a counter-risk position to said consumers; and
 - (c) initiating a series of transactions between said commodity provider and said market participants at a second fixed rate such that said series of market participant transactions balances the risk position of said series of consumer transactions.

physical subject matter to a different state or thing.”). The Board expressed hope that the Federal Circuit would take up the matter and clarify the tests—which is precisely what occurred upon Bilski appealing the Board’s decision to the Federal Circuit in early 2007.

The *Bilski* Briefing and Oral Argument

The *Bilski* appeal was fully briefed, including an amicus brief from the American Intellectual Property Law Association that generally supported Bilski’s position, and was argued before a three-judge panel in October 2007. The issue of patentable subject matter under Section 101 already was receiving considerable attention as just days earlier, the Federal Circuit had handed down decisions in two other cases in which patentability was declined to be found under Section 101: *Comiskey (In re Comiskey)*, 499 F.3d 1365 (Fed. Cir. 2007) and *Nuijten (In re Nuijten)*, 500 F.3d 1346 (Fed. Cir. 2007)). The claimed invention in *Comiskey* was an improved method of arbitration that is performed entirely by human action and mental processes, without the use of any particular technology. In its September 2007 decision, the *Comiskey* panel held that where a process is comprised solely of mental processes, the process is abstract and unpatentable unless it embodies, operates on, transforms, or otherwise involves the other two categories of statutory subject matter—namely, the use of a machine or the transformation of matter. *Comiskey*, 499 F.3d at 1376. The court noted that the transformation of data entirely by human action or mental processes, as in the *Comiskey* invention, does not qualify as transformation of matter and is not patentable.

Rather than deciding the *Bilski* appeal at that time, the court *sua sponte* took the unusual step of ordering the case to be reheard *en banc* by the full 12-judge panel. The court sought further briefing on a variety of issues, including whether it should overrule its prior decisions in *State Street* and *AT&T*.

In addition to receiving the requested supplemental briefs from the parties, the court received over 30 *amicus curiae* briefs. These “friend of court” briefs came from a wide range of companies in the financial services, electronics (hardware and software), and pharmaceutical industries, as well as from various patent law associations and academia. The level of interest was indeed high, with many diverse positions being taken on the questions the court had set forth. Ultimately, two of the *amici* were also invited to participate in the oral argument. One *amicus* is Regulatory DataCorp, which takes the position that applied economics falls well within any reasonable definition of “useful arts,” so that

statutory subject matter should only limit claims that are directed to abstract ideas, physical phenomena, or principles of nature. The other *amicus* is a financial services industry consortium which includes Bank of America, Lehman Brothers, MetLife, Morgan Stanley, Wachovia, and several others, who take the position that *State Street* and its progeny are unduly broad both as written and as interpreted, and should be overturned.

Insights Provided by the May 8 Hearing

While one cannot necessarily predict the court’s ruling based solely on questions raised in oral argument, the arguments made at the May 8 hearing, including the nature of the questions and comments from the judges, suggest that the court is dissatisfied with the current enunciations of patentability standards and is grappling with what fixes can and should be implemented.

Chief Judge Michel, in particular, expressed frustration with the *State Street* test, under which patentability of a process involving a “transformation” resides in its achieving a “useful, concrete, and tangible” result, terming these criteria simply “adjectives” that, in turn, needed further explanation and did little to inform the correct result. Questions were posed about the various terms making up the tests: What does “transformation” mean? Is “concrete” different from “tangible”? Is “useful” to be understood as simply the antithesis of the prohibited “abstract concept”? Unfortunately, the answers were few and often more confusing than the questions.

Similarly, in response to questions to counsel for guidance on the proper test to apply, no unified positions were forthcoming from those arguing before the court. Judge Newman sought views about the “space of uncertainty” which appeared to exist between the clearly patentable categories (e.g., tangible and concrete subject matter) and the clearly non-patentable categories (e.g., abstract concepts). Judge Michel, when told by counsel that no “bright line” test was possible, asked whether at least a “dim line” test could be fashioned. But counsel mostly avoided taking firm lines as to what test was appropriate, with one *amici* simply urging that “caution” be applied by the court and that any type of *per se* rule would be improper.

In addition to deciding what test might be appropriate under Section 101, the court focused on how a test should interoperate with the other parts of the Patent Statute. Judge Rader, for example, pointed out that some of the explanations offered by counsel seemed merely redundant of terms already expressed in the

patent statute. Judge Linn and others asked counsel about the interaction between Section 101 and the conditions for patentability set forth in Sections 102 (anticipation), 103 (obviousness), and 112 (lack of written description, lack of enablement, and indefiniteness). In this regard, Mr. Hansen, representing Mr. Bilski, noted that the broader a claim, the more likely it was going to encompass abstract ideas and thus the more likely it was to suffer from lack of enablement. Professor Duffy, making *amicus* arguments in support of Bilski, suggested that to the extent a method encompasses “post solution,” i.e., post mental step, activity, that post mental step activity cannot be obvious over the art. In other words, the mental step cannot impart novelty or nonobviousness on a claim.

The court also expressed concern over the potential impact of a test for patentable subject matter on areas beyond just financial services. One counsel was questioned because the position being urged seemed to invalidate software patents, while another was asked whether the position he was urging might invalidate patents in biologic areas. Other examples of the court’s concerns over the impact of any test arose in the context of hypotheticals that were used to isolate and simplify the issues at hand: a method for throwing curve balls and whether it effected any “transformation” of the ball or its flight path, as well as chiropractic methods to align spines and whether such changes constituted “transformation”.

Except for one of the *amici*—who represented the above-described financial services industry consortium—counsel generally did not press for reversal of either the *State Street* or *AT&T* decision. The reasons given for not doing so ranged from embracing the tests those cases already provided, to keeping the court’s ruling focused on only the subject matter claimed by Bilski rather than digging back into the facts of either *State Street* or *AT&T*. Nonetheless, both the Patent Office and the financial services consortium took the position that a machine could not be merely ancillary to a method claim for the method claim to be patentable.

While the court’s dissatisfaction with the current tests was apparent, it did little to signal in what direction a solution might proceed. In part, this was due to the broad range of approaches and criticisms the large panel voiced: no one direction was apparent. Overall, it appeared that the court is looking for a test that can be uniformly understood and applied, while avoiding one that might have a disastrous impact on patents already issued. The court also expressed concerns about provid-

ing a test that did not cause problems with the Patent Office’s examination process, either by causing the rejection of claims that were proper or by causing the examiner’s to undertake substantive (e.g., prior art) review of claims that were clearly unpatentable.

The court also raised questions concerning what role it can and should have in this process. For example, is it within the power of the Federal Circuit to create another (fourth) category of subject matter excluded from patentability, or was that solely within the province of the Supreme Court or even Congress? Still other questions signaled concern over whether the court could deduce additional categories of non-patentable subject matter or whether it was restricted only to construe current categories.

Observations

The May 8 hearing revealed the predicament that is facing the court: how to fix a patentability standard that doesn’t seem to be working satisfactorily. The essentially philosophical discussions that occurred at the hearing evidenced the court’s appreciation for the possibility any ruling will have impact well beyond the financial methods that are the subject of the Bilski application. It does seem likely that later this year the court will issue a new test, or at least improvements to the current tests. It remains to be seen, however, whether it will provide the absolute clarity that the participants on both sides of the issue are seeking. At the same time, the court’s questions and comments did little to signal a plan to reverse either *State Street* or *AT&T*.

Even after the Federal Circuit hands down its ruling, the prospect remains that the Supreme Court may take up the issue in turn. The dissent in *Lab Corp* indicated that at least some justices have concerns about the present tests and believe that the Supreme Court should be the source of the standard to be used. If those concerns are not satisfied by whatever new standard is ultimately concluded by the Federal Circuit, *In re Bilski* may be headed toward still more judicial scrutiny.



This update was authored by Joshua H. Rawson (+1 212 698 3862; joshua.rawson@dechert.com), Stephen J. Rosenman (+1 202 261 3366; stephen.rosenman@dechert.com), and Muna Abu-Shaar (+1 212 698 3648; muna.abu-shaar@dechert.com).

Practice group contacts

If you have questions regarding the information in this update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/iplitigation.

Martin J. Black
Philadelphia
+1 215 994 2664
martin.black@dechert.com

James Elacqua
Silicon Valley
+1 650 813 4811
james.elacqua@dechert.com

W. Bryan Farney
Austin
+1 512 394 3010
bryan.farney@dechert.com

Joshua H. Rawson
New York
+1 212 698 3862
joshua.rawson@dechert.com

Stephen J. Rosenman
Washington, D.C.
+1 202 261 3366
stephen.rosenman@dechert.com



© 2008 Dechert LLP. All rights reserved. Materials have been abridged from laws, court decisions, and administrative rulings and should not be considered as legal opinions on specific facts or as a substitute for legal counsel. This publication, provided by Dechert LLP as a general informational service, may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome.

www.dechert.com

U.S. Austin • Boston • Charlotte • Hartford • Newport Beach • New York • Philadelphia
Princeton • San Francisco • Silicon Valley • Washington, D.C. • **EUROPE** Brussels
London • Luxembourg • Munich • Paris • **ASIA** Hong Kong