

THE NATIONAL LAW JOURNAL

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NEWS FOR THE PROFESSION

MONDAY, DECEMBER 1, 2008

An incisivemedia publication

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INTELLECTUAL PROPERTY

A new check on patentability

Landmark 'Bilski' case redefines the limits of what can be patented as a business method.

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Special to the National Law Journal

The recent landmark decision of *In re Bilski*, No. 2007-1130, 2008 WL 4757110 (Fed. Cir. Oct. 30, 2008), has changed the landscape for business method patent protection, and will significantly affect a broad range of industries including banking and finance. Since the U.S. Court of Appeals for the Federal Circuit first determined in 1998 that computer-based business methods, often involving financial transactions, were eligible for patent protection, the banking and financial industry have been faced with an ever-increasing burden of patent-related challenges.

In re Bilski has helped define the limits of what can and cannot be patented as a financial business method. It is imperative that banks and financial institutions pay very close attention to this area of law, as it has the potential to significantly affect their bottom line, both today and in the future.

Some of the challenges come from individual patent owners, such as DataTreasury Corp., whose business method patents cover check-imaging processes critical to the industry. In this one case alone, the potential risk to the industry, or to taxpayers if some legislators get their way and successfully enact a law whereby the government directly pays DataTreasury for taking away its patent (property) rights, has been estimated at \$1 billion.

Other challenges involve keeping up with the ever-shifting intellectual property legal framework, from the annual call by many legislators for sweeping patent reform to a steady stream of court decisions that have both built up and chipped away at the rights of financial-related business method patent owners.

U.S. patent protection is afforded to any invention that is deemed to comprise patentable subject matter and is new, useful and nonobvious. There has been an ongoing debate regarding the first of these requirements: What comprises patentable subject matter? 35 U.S.C. 101 defines patentable subject matter to include "any new and useful process, machine, manufacture, or composition of matter."

The U.S. Supreme Court, interpreting the patent statutes, has consistently identified three categories of subject matter

that are not patentable: laws of nature, natural phenomena and abstract ideas. These are recognized as "the basic tools of scientific and technological work." *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972). In *State Street Bank & Trust Co. v. Signature Financial Group*, 149 F.3d 1368 (Fed. Cir. 1998), reversing *State Street Bank & Trust Co. v. Signature Financial Group*, 927 F. Supp. 502 (D. Mass. 1996), the Federal Circuit held that a method of doing something that achieves a "useful, concrete, and tangible result" is patentable.

State Street dealt with a patent for a data processing system that implemented an investment structure for the administration and accounting of mutual funds. The court reversed the lower court's decision and held that the patent was not invalid under 35 U.S.C. 101. *State Street's* invention involved a machine transforming discrete dollar amounts, through a series of mathematical calculations, into a final share price.

The court found that although an invention that consists solely of a "mathematical algorithm" representing nothing more than an "abstract idea" is not patentable, mathematical algorithms that are reduced to some type of practical application with a "useful, concrete, and tangible result," such as *State Street's* resulting share price, are. *State Street* was noteworthy in that it narrowed the proscription against utilizing a process

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that employed an abstract idea, as long as the idea is taken further to a useful result.

For the past 10 years, *State Street* and its “useful, concrete, and tangible result” requirement has guided U.S. Patent and Trademark Office determinations regarding what subject matter could be patented. Application of this standard has led to an ever increasing number of patents covering methods of doing business.

Revisiting business methods

In *In re Bilski*, the Federal Circuit convened en banc to revisit the issue of whether business method patents should be allowed, and if so, what limitations should be placed upon them. The Board of Patent Appeals and Interferences rejected Bernard Bilski’s invention for a method of hedging risk in commodities trading as unpatentable subject matter under 35 U.S.C. 101.

A number of major financial institutions, including American Express Co. and Bank of America Corp., filed amicus briefs encouraging the court to uphold the board and reject Bilski’s patent. Bank of America, a staunch opponent of business method patents, was allowed the rare opportunity to present its case to the full panel during oral arguments in May.

In its decision, released on Oct. 30, the full court voted, 9-3, to uphold the board’s decision. The court found the “useful, concrete and tangible result” inquiry from *State Street* inadequate and reaffirmed that a machine-or-transformation test first outlined by the Supreme Court in *Gottschalk v. Benson*, 409 U.S. 63 (1972), followed in *Parker v. Flook*, 437 U.S. 584 (1978), and reaffirmed in *Diamond v. Diehr*, 450 U.S. 175 (1981), is the proper test of whether any method or process can be patented. *Bilski*, 2008 WL 4757110 at *9. The court left open the possibility that the U.S. Supreme Court may alter, or even set aside, this test in the future to accommodate emerging technologies, and that the Federal Circuit may refine or augment the test and the way it is applied. Id. at *7.

Although rejecting *State Street*’s permissive “useful, concrete and tangible result” test, the *Bilski* decision was not an outright rejection of business method patents. Under the machine-or-transformation test, a business process claim is still patentable if it is tied to a particular machine, or if it transforms an article to a different state or thing. Id. at *11.

Because Bilski’s claims did not limit any process or step to any specific machine or apparatus, the court did not decide whether a claim’s mere “recitation of a computer suffices to tie a process claim to a particular machine.” Id. Inventors and patent practitioners must look to future court decisions for further direction on this prong of the standard, though it is widely thought that a business method that merely takes place on a computer is probably not sufficiently tied to a particular machine or apparatus, but if the application specifically describes how the computer is used to perform the invention, it probably will pass muster.

‘Useful, concrete and tangible result’ test is no longer operative.

The *Bilski* court did address the requirements for transforming an article. The court found that transformation or simple manipulations of legal obligations, organizational relationships, business risks or other such abstractions cannot meet the test “because they are not physical objects or substances, and they are not representative of physical objects or substances.” Id. at *13.

Impact on financial industry

Between the successful patent application in *State Street* and the failed

attempt in *Bilski*, numerous patents have been granted for financial services-related inventions. U.S. Patent No. 6,112,190, assigned to Citigroup Inc., encompasses the process of originating, underwriting and documenting a commercial bank loan. U.S. Patent No. 6,125,255, for retirement-planning software, models both fixed-income securities and equity securities into the future.

U.S. Patent No. 6,154,732 is a method for enabling employees to manage their benefit plan assets by accessing independent money managers. U.S. Patent No. 6,076,072 enables customized communications with financial services customers. These examples are but a drop in the bucket. Since *State Street*, patents have been granted that cover most common services offered by financial firms, and the grant of a U.S. patent allows the holder to exclude others from practicing the patent.

The story of just one small company’s exploits against the financial industry illustrate that substantial threats can come from unlikely places.

In 1994, an out-of-work computer programmer named Claudio Ballard was having pizza with his father. Ballard took note of the pizzeria’s logistical burden in saving customer receipts—seven years of which were being stored in shoeboxes—and conceived of a method of electronically storing and retrieving the financial papers, including receipts, checks, etc. The value of such technology in the financial industry was enormous, given that large institutions frequently were each processing in excess of 1 billion checks annually.

With financial backing through an attorney friend, Ballard ultimately filed for patent protection in 1997, with patents issuing in 1999 and 2000. These patents became the foundation of DataTreasury Corp. Formed in Melville, N.Y., in 1998, DataTreasury did not sign its first commercial client until 2002. Instead of focusing its business on products and licensing, it carefully planned and unleashed a storm of patent litigation against the financial industry.

Suits against prominent banks

DataTreasury hired Nix, Patterson & Roach, a firm already well-known for its role in obtaining in excess of \$17 billion in a tobacco settlement for the state of Texas. For its venue, DataTreasury chose the U.S. District Court for the Eastern District of Texas, a patent “rocket docket” viewed as favorable for patent owners. (It bears noting that since that time, the “rocket” has slowed dramatically due to a massive influx of new patent case filings.)

Patents granted under ‘State Street’ could be invalidated.

DataTreasury has since sued more than 50 companies, including some of the most prominent players in the financial industry: Bank of America, JPMorgan Chase & Co., Wachovia Corp. (recently bought by Wells Fargo & Co.), Citigroup, Bank of New York, Compass Bancshares Inc., PNC Bank and NCR Corp.

Using classic plaintiffs’ strategy, DataTreasury offered smaller defendants the opportunity to get out early and fairly cheaply. For example, Affiliated Computer Services of Dallas paid \$50,000 in a reported settlement in June 2003. These small settlements, in turn, helped finance DataTreasury’s continuing litigation against larger players with higher volumes of accused practices and much deeper pockets.

In 2005, Citigroup reportedly processed 2.4 billion checks, Bank of America processed 9.4 billion and Wachovia processed 3.7 billion. At these volumes, even a tiny per-transaction royalty represented a rich target to pursue. DataTreasury acquired additional patents and filed additional lawsuits, increasing the pressure.

Long before the big financial bailout package passed, Congress considered a “little bailout” to protect these banks against DataTreasury’s patents. The proposed amendment to the Patent Reform Act would have granted banks immunity from DataTreasury’s lawsuits. While the provision initially passed through the Senate Judiciary Committee without dissent, it drew media attention and criticism.

The Commerce Department formally objected, stating that “the Administration does not support exceptions to patent protection based on a particular technology.” The Congressional Budget Office estimated that the taking effected by the provision would cost the federal government \$1 billion in the course of 10 years.

The proposed amendment was eventually dropped last spring, upon discovery that it would affect a greater number of check-processing technologies than originally thought, and concern that it would send the wrong message to foreign competitors about U.S. patent protection. The broader Patent Reform Act died in committee soon afterward. DataTreasury’s litigation now appears free to move forward.

Preventive measures

Financial firms face an extremely difficult and dynamic economic landscape. Company failures, mergers and bailouts are commonplace. In this environment, financial firms increasingly will be valued based on their intellectual property portfolio.

It is likely that many of the financial services-related business method patents granted in the wake of *State Street* will be invalidated based on the stricter standards announced in *Bilski*. It also is likely that business method patents become harder to obtain in the future. However, those patents that are either sufficiently tied to a machine or apparatus, or that transform physical objects, should survive the stricter *Bilski* test.

For example, two of Ballard’s DataTreasury patents were re-examined by the U.S. Patent and Trademark Office in 2007 and it not only found them valid, but also granted DataTreasury additional patent claims. This re-examination process was going on at the same time that *Bilski*’s patent application was being rejected by the same Patent Office.

A well-written patent that meets the machine-or-transformation test goes a long way toward protecting financial companies from the risk of others asserting their intellectual property against them. Patent litigation can be very costly, and an unfavorable decision can potentially lead to millions of dollars of liability.

However, the patenting process can be lengthy and expensive. Even after the court’s *Bilski* decision, there will continue to be uncertainty in this arena due to growing sentiment for wholesale patent reform, and the continuing possibility that in the future courts will further restrict the patentability of business methods.

Everyone in the financial community needs to be aware of patented business methods. The stakes are potentially very high, and ignorance of the patent landscape can lead to considerable liability.

Business method patents certainly can impede the unfettered conduct of business, but until the day that courts determine that business methods are not patentable, it is advisable that financial firms consult with intellectual property counsel to help steer them through these shark-filled waters. **NLU**

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