

# SMART PILL

## WHAT IS PATENTABLE?

An upcoming Federal Circuit decision should draw a clearer line regarding business method patents.

By Matthew Becker and Thomas Hedemann

**I**n its 1998 State Street Bank decision, the Court of Appeals for the Federal Circuit decided that business methods could constitute patentable subject matter. Since then, the U.S. Patent and Trademark Office has issued an increasing flow of business method patents—from just over 300 in 1998 to almost 1,200 in 2006. Many of these patents, such as Amazon.com's One-Click patent and Priceline.com's reverse auction patent, involve methods of doing business on the Internet.

Financial services companies, however, are also increasingly building intellectual property portfolios. The PTO has currently granted roughly 300 patents classified as insurance patents and hundreds more classified as "portfolio selection, planning or analysis." Among these is the controversial "SOG RAT" tax strategy patent for transferring stock options to younger generations with favorable tax consequences. That patent issued in 2003 and spawned a significant number of similar applications—60 tax strategy patents

have now issued.

As significant as the last decade's increase in business method patents has been, a further expansion may be less than six months away. Until now, the PTO has been reluctant to issue patents for business methods that are not implemented by a

Until now, a **business method** was unlikely to be patentable unless it was **implemented by a machine**. A pending Federal Circuit decision may change that.

machine (such as a computer) in some way, reasoning that they are too abstract to be patentable. This limitation on patentable business methods may soon disappear as the Federal Circuit is set to decide *Ex Parte Bilski*, a case involving a patent application for a hedging method for commodity traders that does not require a computer or other machine for its implementation. Oral argument on the case has been scheduled for October 1, 2007.

Subject matter is patentable according to statute if it falls

into one of the categories of "process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." A business method is considered a "process." Under longstanding Supreme Court precedent, however, abstract ideas (along with laws of nature and physical phenomena) are not patentable subject matter. The PTO concluded that the hedging method disclosed in the Bilski patent application was merely an abstract idea

and consequently rejected the application. In a 3-2 decision that seemed calculated to elicit guidance from the Federal Circuit as to the appropriate test for determining what is too abstract to be patentable, the Board of Patent Appeals and Interferences upheld the rejection.

The Board identified three possible subject matter tests: the Transformation test, the Abstract Ideas Exclusion test and the "useful, concrete and tangible result" test. The Transformation test, which the Board believes is decisive, is derived

from the Supreme Court's definition of a "process" as "an act, or series of acts, performed on the subject matter to be transformed and reduced to a different state or thing." As the Board interprets this test, the subject matter transformed may be intangible (such as the conversion of heat into other forms of energy) but it must be "physical." The Abstract Ideas Exclusion test is conceived by the Board as a "backup check" on the Transformation test and looks in part to see whether the disclosed idea is claimed in the context of a real-world application, in which case it is not abstract. Finally, the Board identified a "useful, concrete and tangible result" test in the three Federal Circuit cases *In re Alappat*, *State Street*, and *AT&T Corp. v. Excel Communications, Inc.* Because it focuses on the result of the disclosed process rather than the process itself, many non-machine-implemented business methods should be patentable under this test. In the Board's view, however, the test applies only to the "special cases" of claims that involve the transformation of data by a machine.

Thus, while the narrow issue before the Federal Circuit is whether the hedging method in the *Bilski*

patent application is an abstract idea, the case provides the court with an opportunity to determine the appropriate test for whether a process constitutes patentable subject matter and hence whether non-machine-implemented business methods are generally patentable. Recognizing the importance of the case, the American Intellectual Property Law Association has

**The AIPLA's amicus brief in support of the applicant: Transformation is merely a clue to the patentability of a process, and not a decisive test.**

submitted an amicus brief in support of the applicant. AIPLA's position is that transformation is merely a clue to the patentability of a process and not, as the Board believes, a decisive test. In AIPLA's view, the Supreme Court set out a general test for process claims in the 1981 decision *Diamond v. Diehr*. This test asks whether the process, when viewed as a whole, recites a practical application with a useful result. The Federal Circuit's "useful, concrete and tangible result" test is, therefore, simply an articulation of the Supreme Court's general test and not limited to the "special case" of data transformation by a machine or machine-implemented

process. Since the disclosed hedging method is directed toward a practical application with a useful result, AIPLA concludes, it constitutes patentable subject matter.

If the Federal Circuit adopts AIPLA's position, the PTO will have to widen the range of business methods it considers to be patentable processes. Companies in industries where intellectual property has traditionally not been thought of as an essential part of the business strategy will need to consider the potential

defensive or offensive utility of building a patent portfolio. Should the Federal Circuit affirm the Board's decision and reasoning, on the other hand, this will tend to suppress patent portfolio building in businesses that otherwise would have done so, and could also have negative implications for the validity of non-machine-implemented business patents that have already been issued. Either way, *Ex Parte Bilski* promises to be a decision with important implications. ■

*Matthew Becker is a partner and Thomas Hedemann is an associate at Axinn, Veltrop & Harkrider in Hartford, Connecticut.*