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Advisory

En Banc Federal Circuit to Revisit the Scope of Patentable Subject Matter: Will Business Method Patents Survive?

by James G. Gatto and Larry J. Hume

From at least 1980 until recently, the trend was that the Court of Appeals for the Federal Circuit (CAFC) and the U.S. Supreme Court had been expanding the scope of patentable subject matter in the U.S. under 35 U.S.C. §101 ("Section 101") to include Living Organisms¹, Computer Software², and Business Methods³. However, some CAFC judges may believe that the pendulum of patentable subject matter has swung too far, particularly in the burgeoning area of business method patents.

As evidence of this, the CAFC recently decided, *sua sponte*, to review this issue en banc in *In re Bilski*. The *Bilski* case follows on the heels of two recent CAFC decisions—*In re Nuijten*⁴ and *In re Comiskey*⁵—which limited the scope of patentable subject matter available in the United States for propagating signals and mental processes, respectively. The 12-judge en banc panel announced that it may also revisit the *State Street Bank* decision, which led to the wave of business method patents filed since that 1998 decision.

This Client Advisory summarizes the background and facts of *Bilski*, the current tests for patentable subject matter of business methods, the issues to be heard en banc in *Bilski* and what the CAFC's decision to rehear this case en banc may portend. If you want to ensure that you receive any updates that we prepare on this topic, please email us⁶ and we will include you on our mailing list for this topic.

¹ *Diamond v. Chakrabarty*, 447 U.S. 303 (1980).

² *In re Beauregard*, 53 F.3d 1583 (Fed. Cir. 1995).

³ *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

⁴ *In re Petrus A.C.M. Nuijten*, No. 2006-1371, (Fed. Cir., Sep. 20, 2007), *en banc reh'g denied* Feb. 11, 2008 (Note: Given the strong dissent in *Nuijten* and recent denial of en banc rehearing by the CAFC, it is possible that the Supreme Court could revisit the scope of patentable subject matter under Section 101 by granting certiorari in *Nuijten*.)

⁵ *In re Stephen W. Comiskey*, No. 2006-1286, (Fed. Cir., Sep. 20, 2007).

⁶ James G. Gatto or Larry J. Hume

Background

The Federal Circuit announced *sua sponte* on February 15, 2008 that it will review the test for patentability of a claimed process under 35 U.S.C. §101. The review will occur in connection with *In re Bilski*⁷. The *Bilski* claims relate to hedging methods associated with methods of managing the consumption risks associated with selling a commodity at a fixed price. The case was previously briefed and argued to a CAFC panel (Clevenger, Bryson, and Moore). The court then asked for supplemental briefing on the issues set forth below. The parties' simultaneous briefs are due March 6, 2008, and amicus briefs are due 30 days thereafter. En banc oral argument is scheduled for 2:00 pm on May 8, 2008.

Prior Precedent

The Federal Circuit's decision in *State Street* is often pointed to as the event that opened the recent flood-gates to business method patents. The *State Street* patent related to a computerized accounting system for a "Hub and Spoke" financial services configuration necessary for maintaining a partnership portfolio and partner fund ("Hub and Spoke"). This involved making a daily allocation of assets of two or more funds ("Spokes") that are invested in a portfolio ("Hub").

In *State Street*, the core issue was whether computer software that essentially performs mathematical accounting functions and is configured to run on a general purpose (i.e., personal) computer is patentable under 35 U.S.C § 101. The CAFC stated:

...claim 1 is directed to a machine programmed with the Hub and Spoke software and admittedly produces a "useful, concrete, and tangible result." *Alappat*, 33 F.3d at 1544, 31 U.S.P.Q.2D (BNA) at 1557. This renders it statutory subject matter, even if the useful result is expressed in numbers, such as price, profit, percentage, cost, or loss.

The CAFC added that:

...[T]he **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. (emphasis added)

With respect to the perceived business method exception, it added:

The business method exception has never been invoked by this court, or the CCPA, to deem an invention unpatentable. Application of this particular exception has always been preceded by a ruling based on some clearer concept of Title 35 or, more commonly, application of the abstract idea exception based on finding a mathematical algorithm.

Despite the fact that this patent claimed a data processing system, many in the patent field looked to the holding and dicta in *State Street* to mean that pure business methods or "processes" could be patented, provided they produced "a useful, concrete and tangible result."

⁷ *In re Bernard L. Bilski and Rand A. Warsaw*, Fed. Cir. Case No. 2007-1130, Feb. 15, 2008 Order (*sua sponte* grant of en banc hearing).

However, in *Comiskey*, a recent case involving claims to a mental process relating to a method of doing business, the CAFC affirmed the Section 101 rejection of claims directed to methods of mandatory arbitration, holding that that an invention that **solely** relies upon a human's intelligence and mental processes is not patentable subject matter.

While *Comiskey* eliminated the patentability of inventions relating **solely** to mental steps, **it did not entirely do away with business method patents**. In *Comiskey*, the CAFC relied upon previous Supreme Court cases holding that a claim reciting an algorithm or abstract idea may be considered statutory subject matter if, as employed in the process, it is embodied in, operates on, transforms, or otherwise involves another class of statutory subject matter, i.e., a machine, manufacture, or composition of matter. The CAFC further noted in *Comiskey* that the Supreme Court has recognized two instances in which such a method may qualify as a Section 101 process, i.e., when the process either was tied to a particular apparatus, or operated to change materials to a "different state or thing." As a result of the CAFC's analysis of this precedent, the court came to the conclusion that a claim that involves **both** a mental process and one of the other categories of statutory subject matter, i.e., a machine, manufacture, or composition of matter, **may be patentable** under Section 101. Presumptively, for example, if a business method is claimed as being implemented via a computer, the rationale in *Comiskey* would not necessarily preclude its patentability under Section 101.

Bilski's Claim

Claim 1 of *Bilski* recites:

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.

As can be seen from this claim, no computer or other technology is **necessary** to implement the method. Additionally, at least one of the steps (identifying market participants) can be performed as a mental step. Arguably, there is also no "physical transformation" of any article. Arguably, it produces a "useful, concrete and tangible result," which was a test relied on in *State Street*.

However, the *Bilski* claim is not limited solely to "mental steps," as was the case in *Comiskey*. Arguably, the *Bilski* claim requires a combination of physical steps (e.g., initiating a series of transactions) to be performed (whether by person or computer) and one or more steps that **can** be physical or mental steps (e.g, identifying market participants).

At the Board of Patent Appeals and Interference (BPAI), *Bilski* argued that its claims includes a series of **physical** steps (as opposed to the mental steps in *Comiskey*) that achieve a **practical** result. The BPAI,

however, found the claims to be non-statutory for failing to indicate that the invention accomplishes **any type of physical transformation**. As detailed below, it is not clear from *State Street* that a physical transformation is required for patentability if there is a “useful, concrete and tangible result,” but that is an issue the CAFC will likely address.

Legal Issues to be Addressed by the En Banc Federal Circuit

Some of the issues that may need to be addressed by the en banc CAFC are whether the steps in *Bilski* of “initiating a series of transactions...” are physical process steps and, if so, do they produce a “useful, concrete and tangible result.” Even if they do, is that sufficient for them to fall within the definition of patentable “process” as that term is used in Section 101? Or, will the CAFC require, as the BPAI did, that there must be a physical transformation for the claim to be patentable?

Assuming the *Bilski* claim is determined to involve one or more physical steps, it is unlikely that the claim will be found unpatentable **due to the holding in *Comiskey***. However, the fact that CAFC is rehearing the case en banc, by its own action, suggests that it will address more completely the test for the patentability of processes such as business methods. If the CAFC determines the *Bilski* claim to be unpatentable, the court may refine the test for patent-eligible subject matter. If it does, where will it draw the line? Perhaps the list of issues to be reheard en banc provides some clues.

Specifically, the CAFC requested supplemental briefs to address the following five questions:

1. Whether claim 1 of the 08/833,892 patent application claims patent-eligible subject matter under 35 U.S.C. § 101;
2. What standard should govern in determining whether a process is patent-eligible subject matter under section 101;
3. Whether the claimed subject matter is not patent-eligible because it constitutes an abstract idea or mental process; when does a claim that contains both mental and physical steps create patent-eligible subject matter;
4. Whether a method or process must result in a physical transformation of an article or be tied to a machine to be patent-eligible subject matter under section 101; and
5. Whether it is appropriate to reconsider *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), and *AT&T Corp. v. Excel Communications, Inc.*, 172 F.3d 1352 (Fed. Cir. 1999), in this case and, if so, whether those cases should be overruled in any respect.

Question 3 suggests that the CAFC may believe the *Bilski* claims include a combination of mental steps and physical steps.

Question 4 above seems likely to get to the crux of the matter, and Question 5 may suggest something about the ultimate result. Specifically, Question 4 will address whether a claim that recites physical steps must result in a “physical transformation” of an article or be tied to a machine to be patent-eligible subject matter under Section 101. If the CAFC is inclined to so hold, then it might well be that this would modify the holding in *State Street*, thus potentially explaining the need for an en banc panel. If the CAFC panel was inclined to simply decide this case based on distinguishing it from *Comiskey* or based on existing law, it

would not need an en banc panel to do so. The desire to address Question 5 en banc may portend a change to the “useful, concrete and tangible” result test of *State Street*.

Conclusion

The state of patentable subject matter is in flux. Now, more than ever, it is advisable to consider various claim types, including system claims, computer-implemented process claims, pure method claims, etc. We recommend that you consult with a knowledgeable patent attorney to understand the strategy and benefits behind each claim type and the likely patentability of those claim formats for each unique invention.

We will continue to monitor relevant activities and provide updates over time. In the interim, to the extent you have specific questions regarding patent issues, particularly related to business method patents, please feel free to contact us.

For further information, please contact:

James G. Gatto (bio)

Northern Virginia
+1.703.770.7754
james.gatto@pillsburylaw.com

Larry J. Hume (bio)

Northern Virginia
+1.703.770.7981
larry.hume@pillsburylaw.com

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