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Trick or Treat?
The Federal Circuit Court Restricts Protection of Business Method Patents

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On October 30, 2008, the United States Court of Appeals for the Federal Circuit ("Federal Circuit") issued its greatly anticipated decision in *In re Bilski*, Case No. 2007-1130, which addressed the patentability of business methods. The majority opinion ruled that a claimed process is eligible subject matter for patentability if (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing. Thus, the Federal Circuit has limited to some extent the protection of business method patents.

Background

Section 101 of the Patent Act defines what types of inventions are patentable. It defines a patentable invention as "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." The Supreme Court has interpreted this definition broadly to include anything under the sun that is made by man. The only limitation to the scope of patentable subject matter is the product of nature doctrine. The product of nature doctrine denies patent protection to the laws of nature, physical phenomena, and abstract ideas. For a number of years, Supreme Court precedent and United States Patent and Trademark Office ("USPTO") guidelines viewed business methods as products of nature, and thus unpatentable, unless they were tied to some sort of physical transformation or performed on a machine.

In the 1998 *State Street Bank & Trust Co. v. Signature Financial Group, Inc.* decision, the Federal Circuit held that business methods are proper subject matter for patent protection if they produce a useful, concrete, and tangible result. Following the *State Street* decision, applicants flooded the

USPTO with patent applications directed to business method patents. The USPTO has granted business method patents for Amazon's 1-Click online purchasing process, Priceline.com's name your own price reservation method, Netflix's movie rental system and H&R Block's tax refund process.

Critics of the *State Street* decision argued that its holding should be reversed or limited. They argued it has hindered businesses fearful of conducting business in a manner that could infringe upon these often broad and unclear business method patents. Also, they asserted that patents have been granted for business practices that have been utilized for a number of years, which have forced companies to either pay royalties or incur legal expenses in litigation to invalidate such patents. Proponents of business method patents claimed that such methods should be afforded patent protection as long as they satisfy the existing legal tests including novel, useful and not obvious.

Procedural History

In re Bilski involves the appeal of a rejection of a patent application directed to a method for managing the consumption risk costs of a commodity sold by a commodity provider at a fixed price. The patent application was rejected by the USPTO under 35 U.S.C. § 101 as nonstatutory subject matter. The applicant appealed to the Board of Patent Appeals and Interferences ("BPAI"), which affirmed the rejection because the application merely claimed an abstract idea. The BPAI held that a patentable process must either transform matter or energy or use a machine to carry out specified steps.

The BPAI asked for clarity from the Federal Circuit regarding the subject matter patentability of non-technological method claims. The applicant appealed the BPAI's decision to the Federal Circuit.

The Federal Circuit initially heard oral arguments on the appeal on October 1, 2007. Rather than issue an opinion, the Federal Circuit issued an order on February 15, 2008 for a rehearing of arguments en banc. The Federal Circuit requested the parties 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?
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?

The Federal Circuit heard oral arguments on May 8, 2008. On October 30, it issued its ruling affirming the BPAI's rejection of the patent application.

Bilski Decision

Although the *Bilski* appeal initially involved the narrow question of whether Bernard Bilski's patent should have been granted, the Federal Circuit used the appeal to address the broader question of the scope of business method patents. The Federal Circuit held that a claimed process is eligible subject matter under 35 U.S.C. §101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing. The Federal Circuit referred to this test as the machine-or-transformation test, which was initially adopted by the Supreme Court over three decades ago.

The Federal Circuit noted two important corollaries of the machine-or-transformation test. First, the use of a specific machine or transformation of an article must impose meaningful limits on the claim's scope to impart patent eligibility. In addition, the involvement of the machine or transformation in the claimed process must not be merely insignificant post-solution activity.

The Federal Circuit rejected a number of tests either previously used by the Federal Circuit or urged to be adopted in the amicus briefs, including the *Freeman-Walter-Abele* test, the *State Street* test, and the "technological arts" test. The *Freeman-Walter-Abele* test involved two steps: (1) determining whether the claim recites an algorithm, then (2) determining whether the algorithm was applied in any manner to physical elements or process steps. The *State Street* test allowed patent protection if the process provided a useful, concrete and tangible result. The Federal Circuit concluded that both tests were inadequate and the machine-or-transformation test is the proper test to apply. In addition, the Federal Circuit rejected the technological arts test that sought to limit business method patent protection to patents involving the application of science or mathematics. The majority opinion also rejected the call to make all business method patents unlawful and instead held that business method patents are subject to the same requirements for patentability as any other process or method.

The Federal Circuit did not address the issues specific to the machine implementation part of the test and left that issue for future cases to resolve. The Federal Circuit did attempt to provide some clarity on the transformation part of the test. It noted that the transformation test requires clarification as to what types of things qualify as articles such that their transformation is eligible for patent protection. Such items are clear when involving physical or chemical transformation; however, it becomes much more complicated when it involves electronic signals, electronically-manipulated data or business methods. The Federal Circuit reviewed its prior case law that took a measured approach to this question and chose not to expand the boundaries of what constitutes patent-eligible transformations of articles. Thus, the opinion provided little guidance on the transformation part of the test beyond that set forth in prior precedent.

The Federal Circuit agreed that "future developments in technology and the sciences may present difficult challenges to the machine-or-transformation test, just as the widespread use of computers and the advent of the Internet has begun to challenge it in the past decade." Therefore, the Federal Circuit recognized that the Supreme Court may ultimately revise or reject this test to accommodate emerging technologies. The Federal Circuit also noted that it may need to refine or augment the machine-or-transformation test or how it is applied in future cases.

Judges Dyk and Linn filed a concurring opinion that fully supported the majority opinion but

addressed the two dissenting opinions that criticized the majority's opinion as not being grounded in the statute. Judge Newman's dissent criticized the majority opinion as redefining the term process in the patent statute and, thus, usurping the legislative role of Congress. In his dissent, Judge Rader criticized the majority opinion for relying on dicta from prior Supreme Court precedent for the machine-or-transformation test and found that it was inapplicable in a "time of subatomic particles and terabytes." Finally, Judge Mayer's dissent concluded that patent protection should not be granted to business methods.

Significance

The *Bilski* decision is significant because the Federal Circuit made clear that business methods are subject to patentability as long as they meet the legal requirements of patentability. The Federal Circuit held that the machine-or-transformation test is the appropriate test to determine whether a process qualifies for patent protection under 35 U.S.C. § 101. Thus, the Federal Circuit has reined in to some extent the scope of business method patents. Any patents that have issued in the past ten years since the *State Street* decision but do not satisfy the machine-or-transformation test are likely to be invalidated if challenged. Some patent attorneys, however, have been advising their clients to draft business method patents to satisfy the machine-or-transformation test even post *State Street*. Thus, such patents are still eligible for patent protection under the *Bilski* decision. The Federal Circuit's opinion, however, provides little guidance on the application of the machine-or-transformation test beyond that contained in earlier precedent. Such application of the machine-or-transformation test will likely be decided in future cases or by the Supreme Court.

If you have concerns about your issued patents or pending patent applications, please contact McAfee & Taft or your patent attorney.

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