Federal Circuit Raises The Bar For Patenting Business Methods

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In its much-anticipated, *en banc* decision in *In re Bilski*,[1] the United States Court of Appeals for the Federal Circuit revisited and changed the standard for determining whether so-called "business methods" and other similar processes can qualify for patent protection. Since the Federal Circuit's landmark decision ten years ago in *State Street Bank*[2] that confirmed the patentability of business methods, thousands of such patents have issued – largely in the fields of financial services, insurance, consulting, software and e-commerce – and have attracted both criticism and support from different quarters. Not surprisingly, a large number of industry organizations, corporations and lawyer groups, as well as the Patent and Trademark Office, weighed in on the debate with *amicus* briefs in *Bilski*. While the new standard the Federal Circuit adopted in *Bilski* is somewhat nebulous, it appears more restrictive than the test employed in *State Street Bank* and its impact on one area of interest to Wall Street firms seems clear: claimed inventions directed solely to abstract strategies or schemes (whether for securities trading, hedging schemes or other applications) are unlikely to qualify for patent protection.

The claimed invention in *Bilski* was directed to a method of hedging risk in the field of commodities trading. To illustrate: operators of coal-burning power plants are averse to the risk of a spike in demand for coal that would increase the price of coal; and coal mining companies, conversely, are averse to the risk of a sudden drop in demand that would reduce sales and depress prices for coal. The claimed method envisions an intermediary, the "commodity provider," that sells coal to the power plants at a fixed price, thus isolating the power plants from the risk of a price increase as a result of a spike in demand. The same provider buys coal from mining companies at a second fixed price, thereby isolating the mining companies from the possibility that a drop in demand would lower prices. The provider thus has hedged its risk: if demand and prices skyrocket, it has

[1] No. 2007-1130 (Fed. Cir. Oct. 30, 2008) (en banc).

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

sold coal at a disadvantageous price, but has bought coal at an advantageous price; and, conversely, the provider is likewise hedged if demand and prices fall.

The question in *Bilski* was whether such a claimed invention can satisfy the Patent Act's requirement that patents may be granted only for a "new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." Bilski argued that his hedging scheme qualified for patenting as a "process." The PTO disagreed, finding that the claimed invention merely manipulates an abstract idea and solves a purely mathematical problem. The Board of Patent Appeals affirmed the PTO's rejection, holding that the claimed invention did not involve any transformation of concrete articles and therefore was ineligible for patenting.

When Bilski appealed, the Federal Circuit decided to hear the matter *en banc* and to invite *amicus* briefs on the question of how to determine whether such a claimed process or method qualifies for patenting. In rendering its decision, the court sifted through the various Supreme Court and Federal Circuit pronouncements over the years and chose a standard – described as the "machine-or-transformation" test – as the definitive inquiry for determining the patentability of processes and methods. Under this test, a claimed process is patent-eligible if it is tied to a particular machine or apparatus, or it transforms a particular article into a different state or thing.

Because Bilski's claimed invention clearly was not directed to any particular machine or apparatus, the Federal Circuit had no occasion to flesh out that part of the standard. Instead, it focused on the other branch of the test: whether the claimed invention transforms a particular article into a different state or thing. The court held that it did not, stating that "[p]urported transformations or manipulations simply of public or private legal obligations or 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." Bilski's claimed hedging process "at most incorporate[d] only such ineligible transformations" and thus did not satisfy the new test.

The Federal Circuit's broad statement that "[p]urported transformations or manipulations simply of public or private legal obligations or relationships, business risks, or other such abstractions" cannot qualify for patent protection would seem to preclude any patent directed to an abstract securities trading strategy or hedging scheme. Moreover, in adopting its new standard, the Federal Circuit expressly discarded the more permissive and vague test espoused in *State Street Bank* – that a business method can be patented so long as it achieves a "useful, concrete and tangible result." The *Bilski* decision thus will have an impact on both existing patents and future prosecution strategies. Parties seeking to enforce business method patents issued under the more expansive *State Street Bank* standard may face substantial validity challenges under *Bilski*. And would-be patent applicants who

question whether they can satisfy the more restrictive *Bilski* standard may choose to forgo a patent application altogether.

To the extent *Bilski* exposes existing patents to validity challenges and makes future patent applications less likely to succeed, it joins a series of major decisions in recent years that have tilted the legal landscape against patent owners in important ways: the *Festo* decision making it more difficult for patentees to overcome prosecution history estoppel;[3] the *eBay* decision making it more difficult for patent owners to obtain permanent injunctions against infringers;[4] the *MedImmune* decision allowing licensees to challenge a patent's validity while continuing to enjoy the benefit of a license to exploit the patent;[5] the *KSR* decision making it easier to invalidate a patent based on obviousness;[6] and the *Seagate* decision making it more difficult to establish willful infringement in order to recover enhanced damages and attorneys' fees.[7] None of these precedents erects insurmountable obstacles to a patent owner obtaining effective relief against infringers, but they do provide parties accused of infringement with an expanded arsenal of defenses.

For further information about the *Bilski* decision or any of the issues discussed above, please feel free to contact Lawrence Friedman, Leonard Jacoby, David Herrington, or Daniel Ilan, or any of our partners and counsel listed under "Intellectual Property" in the "Our Practice" section of our web site (http://www.clearygottlieb.com).

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3 *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.*, 535 U.S. 722 (2002).

4 *eBay Inc v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

5 *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007).

6 *KSR v. Teleflex*, 127 S. Ct. 1727 (2007).

7 *In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007).

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