

July 1, 2010

---

## U.S. Supreme Court declines to strike down business method patents and holds that the “machine-or-transformation” test is not the sole test for determining patentability of a process.

---

### Summary

On June 28, 2010 the U.S. Supreme Court issued its much anticipated opinion in *Bilski v Kappos*. The Court upheld the Federal Circuit’s determination that Bilski’s processes for hedging risk and applying a hedging concept to energy markets were not patent-eligible subject matter. All nine Justices agreed that Bilski’s processes were unpatentable abstract ideas.

Notwithstanding the Court’s affirmance of the Federal Circuit decision that Bilski’s business risk invention was ineligible patent matter, the Court found that the “machine-or-transformation” test was not the sole test for determining patentability of a process. Providing patentee proponents a sigh of relief, the Court stated that such a limiting test would create “uncertainty as to the patentability of software, advanced diagnostic medicine techniques,” and other inventions.

The Court did not provide any new tests for patent eligibility, but instead based its decision on Supreme Court precedent of past decisions in *Benson*, *Flook* and *Diehr* in ruling that petitioner’s claims to a concept of hedging risk and the application of the concept to energy markets are not patentable because they are attempts to patent “abstract ideas.”

While the Court noted that the statute leaves open the possibility of some business method patents, it does not suggest broad patentability of such claimed inventions. The Court, for example, specifically refused to endorse the Federal Circuit’s earlier broad *State Street* decision. Going forward, the Federal Circuit will continue to shape the contours of patentability in the wake of *Bilski*, but may resist the urge to develop rigid tests.

The Court noted that patent eligibility is just a threshold test. Even if a particular business method fits into the statutory definition of a “process,” in order to receive patent protection, any invention must still also be novel, nonobvious, and sufficiently described.

The *Bilski* decision is likely to be the Supreme Court’s last word on the subject of patent eligible subject matter for some time – but the issue is still confused by seemingly divergent opinions.

### One decision, three sets of opinions

Though the decision as to the *Bilski* patent was 9-0, the Justices wrote three opinions expressing different views as to whether the test for patent eligibility should be broad and whether business methods should be excluded from patentability.

- The Court’s opinion by Justice Kennedy was joined in full only by Justices Roberts, Thomas, and Alito. Justice Scalia joined all but two parts of the opinion, both of which express a strongly pro-patent view.
- Justice Stevens’ opinion (joined by Justices Ginsburg, Breyer, and Sotomayor) concurs in the judgment, but argues that the Court should have excluded all “business methods” from patentability.
- Justice Breyer (joined by Justice Scalia) wrote to highlight the agreement “among many Members of the Court on many of the fundamental issues of patent law.”

### Points of agreement

Notwithstanding the differing views expressed in the opinions, there was, according to Justice Breyer, “substantial agreement among many Members of the Court on many of the fundamental issues of patent law raised by this case.” Justice Breyer wrote separately (joined by Justice Scalia), to highlight the following points of agreement:

“although the text of §101 is broad, it is not without limit”;

“the so-called ‘machine-or-transformation test’ has thus repeatedly helped the Court to determine what is a patentable process”;

“while the machine-or-transformation test has always been a ‘useful and important clue,’ it has never been the ‘sole test’ for determining patentability”; and

“although the machine-or-transformation test is not the only test for patentability, this by no means indicates that anything which produces a ‘useful, concrete, and tangible result’ is patentable.”

The last point is a reference to the patent eligibility test set forth in the Federal Circuit’s ruling in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998). The majority did not specifically reject the State Street holding, but specifically citing that case, said, “Nothing in today’s opinion should be read as endorsing the Federal Circuit’s past interpretations of §101.”

### Business methods are not excluded from patent eligibility

The Court held that the Federal Patent Act does not categorically exclude business methods from eligibility to be patented. The word “method” within the law’s definition of “process” may include at least some methods of doing business. The Court explained that it was “unaware of any argument that the ‘ordinary, contemporary, common meaning’ ... of ‘method’ excludes business methods,” citing its ruling 19 years ago in *Diamond v. Diehr*, 450 U.S. 175.

Four of the Justices did not agree and argued that all business methods should be excluded from patent eligibility. In a 47-page separate opinion in the *Bilski* case, Justice Stevens, joined by Justices Ginsburg, Breyer, and Sotomayor, argued that business methods should not be patentable.

Thus, there seem to be two competing camps of Justices -- four who favor a broad standard of patentability and four who favor excluding all “business methods” from patent eligibility. Justice Scalia (the swing vote) rejected an outright prohibition against the patenting of business methods, but did not sign on to the broad standard.

The seemingly disparate views may not be as far apart as they seem since there may not be much difference between what Justice Stevens calls a “business method” and what Justice Kennedy calls an “abstract idea.” The definition of “business method” has always been elusive and Justice Stevens’ opinion does not define the scope of the proposed “business method exception” to patentability. The “business methods” that Justice Stevens had in mind may have been a simple series of steps for implementing an abstract idea, but the ambiguity of the term “business method” could have led to attacks against any

patents for information age innovation such as software, advanced diagnostic medicine techniques, and inventions based on linear programming, data compression, and the manipulation of digital signals

### Patent eligibility under §101

The Court in *Bilski* did not provide a bright line test for patent eligibility. Ultimately the Supreme Court seemed very aware that a broad ruling could have unforeseen consequences and therefore chose a more narrow approach of deciding that the particular patent before it was an unpatentable “abstract idea” precluded from patentability by the Court’s prior precedents.

With the Court’s guidance, it is now up to the Federal Circuit (and district courts) to “shape the contours of patentability.” In this regard, the courts must clarify the scope of the “abstract idea” exception to patentability. But the Federal Circuit may be reluctant to provide a rigid single test that could be knocked down by the Supreme Court as in *Bilski*. Instead, the court may come up with a series of different factors to consider in determining what may or may not be an “abstract idea.” The Federal Circuit *Bilski* opinion (which was the subject of review by the Supreme Court) may provide some insight as to the scope of the “abstract idea” exception. The Federal Circuit provided further guidance regarding purely mental processes holding that processes are ineligible for patent protection if all the process steps are capable of being performed in the human mind.

The opinion of Chief Judge Rader in the Federal Circuit *Bilski* decision may also be instructive. In his dissent, Judge Rader agreed with the majority regarding the non-statutory nature of *Bilski*’s method claim but reached that conclusion by finding that the *Bilski* method claim constituted nothing more than an unpatentable abstract idea. The Supreme Court opinion is largely consistent with Judge Rader’s dissent – that the only exclusions from patent eligible subject matter are “natural laws, natural phenomena, and abstract ideas.” As such, a more restrictive reading of § 101 is unnecessary because the remaining sections of the patent statute (e.g., novelty, nonobviousness and enabling disclosure) are sufficient to preclude the grant of patents for frivolous and useless inventions.

### Implications and Practical Tips

The Court in *Bilski* did not provide the bright line patent eligibility test that some had hoped for. The Court may have recognized that any attempt at a bright line test would fail given the inherent ambiguity of terms such as “abstract idea” and “business method.” Thus, the need for further clarification may have been unavoidable.

As we wait for further guidance, those responsible for IP related strategy should bear in mind the following considerations.

### Patents are now a mainstream business tool

The interest demonstrated by the Court itself and the numerous companies and organizations that filed amicus briefs show that patents are no longer a mere curiosity reserved to certain industrial age companies. Patents are now a mainstream business tool for the information age --a critically important tool for obtaining and retaining market share and generating revenue. Patent strategy should be aligned with business strategy through clear communication among those responsible for business strategy and those responsible for developing and implementing patent strategy, including both in-house and outside counsel. Careful IP diligence may be critical to assessing the value of company in a transaction. Effective patent enforcement and counseling may be essential to monetizing the value derived from an enterprise’s investment in innovation.

### Implications for the Financial Services Industry

The financial service industry would have been most directly impacted by a broad “business method exception” to patent eligibility. But the Supreme Court has now made it clear that, like it or not, the financial services industry is subject to the

same rules of patent eligibility as everyone else. Patents for “business methods” must be treated like other processes for which patent protection is sought -- there is no separate patent eligibility test for “business methods.”

Until we receive further guidance, the financial services industry must confront uncertainty as to the exact scope of patent eligibility for business processes – but such uncertainty has been the rule, not the exception in recent years. The best way to respond to uncertainty remains unchanged: keep options open and take advantage of all available tools for protecting innovation. A patent strategy is essential, but simply applying for patents has never been a complete solution to protecting innovation. The best approach to complete innovation protection remains a holistic integrated approach that makes strategic use of all available tools for protecting innovation including trade secrets, employment agreements, IT asset controls, vendor contracts and, yes, patents.

### Prepare for the “Abstract Idea” defense

Some may argue that the Court in *Bilski* expanded the reach of the “abstract idea” exception to patent eligibility. Patent owners should anticipate that accused infringers will argue that patents related to software, advanced diagnostic medicine techniques and other information age inventions will be attacked as covering “abstract ideas.” Companies accused of infringing should consider the availability of an “abstract idea” defense.

### Creative Patent Claim Drafting Strategies

*Bilski* reaffirms that there is no business method or software exception to patentability. The Court, however, declined to provide details as to when, and under what circumstances, a process is an unpatentable abstract idea.

It may be possible to overcome or even avoid future “abstract idea” challenges to patent claims through creative patent claim drafting strategies. For example, in the context of software patents, the inclusion of hardware limitations may be helpful in avoiding/overcoming arguments that business processes that are implemented on computers are merely abstract ideas. Hardware limitations that call for the computer to actually implement a significant aspect of the claimed method may be better received than having a computer simply function as a device to store, display and/or retrieve data. Of course, it is still required that software based claims must not only meet the standards of novelty and non-obviousness under § 102 and § 103, but also the disclosure requirements under § 112 which mandate, at very least, disclosure of the key algorithms embedded in the software.

This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Michael D. Bednarek  
Washington, DC  
+1.202.508.8000  
michael.bednarek@shearman.com

Scott W. Doyle  
Washington, DC  
+1.202.508.8000  
scott.doyle@shearman.com

Vicki S. Veenker  
Menlo Park  
+1.650.838.3600  
vicki.veenker@shearman.com

Adam P. Noah  
San Francisco  
+1.415.616.1100  
adam.noah@shearman.com