

Bilski v. Kappos: U.S. Supreme Court Declines Categorical Rejection of Business Method Patents

In a much-anticipated decision handed down yesterday, the United States Supreme Court unanimously upheld the Federal Circuit's *en banc* ruling affirming the U.S. Patent & Trademark Office's rejection of patent claims for a method of hedging commodities risks as ineligible for patent protection under 35 U.S.C. § 101. See *In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008), *aff'd Bilski v. Kappos*, 561 U.S. ___, slip op. No. 08-964 (June 28, 2010). The Court divided sharply, however, regarding the analysis underlying that conclusion and left many important questions for lower courts and the PTO to resolve concerning the tests to be used to determine the patentability of business methods and other "processes" under Section 101.

Some commentators had expected a decision that one way or another would clearly spell the end of so-called "business method" patents. Instead, by a 5-4 majority, the Court declined to hold that methods of conducting business are categorically not patentable. And while all the Justices agreed that Mr. Bilski's patent claims were directed to an unpatentable "abstract idea," a category long recognized as outside the scope of patentable subject matter, yesterday's majority opinion and two concurring opinions offer little additional guidance as to when a business method falls within that category.

The Justices also agreed unanimously that while the "machine-or-transformation" test can be an important clue to patentability, it is *not* the exclusive test for determining what process inventions are eligible for patenting under the statute. The Federal Circuit's controversial adoption of the "machine-or-transformation" test as the *sole* measure of whether process claims are drawn to patentable subject matter had called into question not only the patentability of business methods, but also that of various computer-implemented technologies, such as software, as well as some medical diagnostic methods. In a separate order issued today, the Supreme Court remanded to the Federal Circuit for consideration in light of *Bilski* a case (*Prometheus Labs. Inc. v. Mayo Collaborative Services*) squarely raising the question of what test for patentability under Section 101 should be applied in the context of patents covering medical diagnostic methods. In addition, the Federal Circuit is now faced with a number of appeals from district court decisions invalidating computer-implemented method claims under Section 101 that had previously been stayed pending release of the Supreme Court's decision in *Bilski*.

Notably, each of yesterday's opinions in *Bilski* made a point of observing that the Supreme Court's rejection of the Federal Circuit's concept of an *exclusive* "machine-or-transformation" test should not be understood to reflect an endorsement of other tests previously used by the Federal Circuit, such as the "useful, concrete and tangible result" test applied in the *State Street Bank* case and often cited as having ignited an explosion of business method patent applications.

The Supreme Court expressly declined to articulate any alternative to the "machine-or-transformation" test for determining the patent-eligibility of business methods and other processes under Section 101. The Court's professedly narrow holding leaves it to the lower courts and the PTO to attempt to develop more specific answers to questions such as: (1) under what circumstances is it appropriate or inappropriate to look to the "machine-or-transformation" test for guidance as to the patent-eligibility of a "process" invention? (2) under what circumstances, if any, is it appropriate to look to the "machine-or-transformation" test as determinative of that question? and (3) what other tests are proper, and when should they be applied?

What is certain is that a great deal of effort and expense on the part of litigants, patent applicants and the PTO will be dedicated to shaping the answers to such questions. In the meantime, any companies that have de-emphasized patent strategy in their business planning, or discounted potential patent risks,

based on assumed categorical implications of the machine-or-transformation test should revisit that assessment in light of *Bilski*.

Background

35 U.S.C. § 101 provides that “[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.”

The provision governs the scope of patent-eligible subject matter and is broadly conceived. Supreme Court jurisprudence, however, has always excluded laws of nature, natural phenomena and abstract ideas from the scope of patent-eligible subject matter, while maintaining that certain practical applications of such fundamental principles may be patentable. Historically, the U.S. Patent and Trademark Office also drew a distinction between the technological arts and methods of organizing human activity (e.g., methods of conducting business). “Business methods,” as contrasted to advances in the technological arts, were not considered patent-eligible subject matter.

In 1998, however, the Federal Circuit rejected the *per se* exclusion of business methods from patent protection in a decision known as *State Street Bank*. *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998). The patent at issue in *State Street Bank* claimed a computer-implemented “Data Processing System for Hub and Spoke Financial Services Configuration” wherein the “spokes” were mutual funds that pooled their assets in a central “hub” organized as a partnership. The Federal Circuit reversed a district court determination that the patent was invalid under Section 101, holding generally that methods having a “useful concrete and tangible result” were eligible for patent protection. Following *State Street Bank*, business methods patents became common-place, covering the full gamut of commercial activity, from methods for structuring financial transactions to methods for tax avoidance.

On October 30, 2008, the Federal Circuit’s *en banc* decision in *Bilski* abruptly called into question the validity of all such patents. The decision sustained a finding by the PTO Examiner—which had been upheld by the Board of Patent Appeals and Interferences—that Bilski’s eleven method claims for hedging commodity prices were not drawn to patent-eligible subject matter.

In so doing, the court repudiated the “useful, concrete and tangible result” test of *State Street Bank* and held instead that in order to be patent-eligible, a method or process claim must either:

- (i) be meaningfully tied to a particular machine or apparatus, or
- (ii) transform a physical article or representation thereof into a different state or thing.

The Federal Circuit’s “machine-or-transformation” test, as the test articulated in *Bilski* quickly became known, was widely perceived as signaling the demise not only of business methods patents, but potentially software and diagnostics patents as well.

Bilski’s Claims

Bilski’s patent claims were of the type commonly known as “business method” claims and were drawn to a financial method for hedging risk. Bilski’s claims did not require the use of a computer or recite any other machine. Representative claim 1 recited:

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.

Test For Patent-Eligible Subject Matter Applied by the Supreme Court in *Bilski*

In affirming the rejection of *Bilski*'s claims, the Supreme Court reasoned that they failed to recite patent-eligible subject matter because they purported to patent both the abstract concept of hedging risk and the application of that concept to energy markets. As the Court explained, "[a]llowing petitioners to patent risk hedging would preempt use of this approach in all fields, and would effectively grant a monopoly over an abstract idea." That some of the claims were limited to the application of the concept of hedging in commodities and energy markets, in particular, constituted mere field of use restrictions that could not salvage the claims.

The Supreme Court's ruling carefully avoids addressing issues beyond those directly presented. In light of the many amicus briefs filed by members of the computer and medical industries expressing concern regarding the validity of their patents, counsel for the government took the position during oral argument that the *Bilski* case provided a poor vehicle for a decision affecting the validity of software and diagnostics patents.

The Court appears to have adopted the government's position on this point. Justice Kennedy's majority opinion expressly resolves the case "narrowly," on the basis that *Bilski*'s claims purport to patent abstract ideas, and declines to adopt "categorical rules that might have wide-ranging and unforeseen impacts" on information age technologies.

Writing for a plurality, Justice Kennedy went on to cite the distinction between the industrial and mechanical processes of the past and the modern technology of the information age as a basis for rejecting the Federal Circuit's application of the "machine-or-transformation" test as the exclusive test for patent-eligible subject matter:

The machine-or-transformation test may well provide a sufficient basis for evaluating processes similar to those in the Industrial Age—for example, inventions grounded in a physical or other tangible form. But there are reasons to doubt whether the test should be the sole criterion for determining the patentability of inventions in the Information Age.

As to the patent-eligibility of business methods, the decision leaves open the possibility that the Federal Circuit might construct a test that would exclude from the scope of patent-eligible subject matter some "narrower category or class of patent applications that claim to instruct how business should be conducted," consistent with the statutory language of Section 101. There appears to be strong support for such an exclusion on the Court. In a concurrence written by Justice Stevens, four justices adopted the position that methods of conducting business, without more, are properly deemed *per se* ineligible for patent protection in the United States. The opinion of the Court, however, states that the "Patent Act leaves open the possibility that there are 'at least some processes that can be fairly described as business methods that are within patentable subject matter under § 101.'"

In a separate concurrence, Justice Breyer, joined by Justice Scalia, wrote to highlight the substantial agreement among the Justices that Section 101, while broad, is not without limit, and that the “machine-or-transformation” test, while not exclusive, is nevertheless an “important example” of a way in which to determine patent-eligible subject matter pursuant to 25 U.S.C. § 101.

Diagnostic Patents and *Prometheus Labs. Inc. v. Mayo Collaborative Services*

Prometheus Labs. Inc. v. Mayo Collaborative Services may afford the Federal Circuit an early opportunity to interpret yesterday’s *Bilski* decision in the context of medical diagnostic patents. See *Prometheus Labs. Inc. v. Mayo Collaborative Services*, 581 F.3d 1336 (Fed. Cir. 2009), *cert. granted*, 78 U.S.L.W. 3254 (U.S. Jun. 29, 2010) (No. 09-490).

In *Prometheus*, the Federal Circuit had upheld a diagnostic patent covering a method for administering thiopurine drug to a patient and subsequently determining the proper thiopurine dosage through an assessment of the patient’s thiopurine metabolite levels. *Id.* Applying the “machine-or-transformation” test last September, the Federal Circuit reasoned that the administration of a drug results in a patent-eligible “transformation” of the human body. *Id.* at 1346. The circuit court further reasoned that the “determining” step in the claims required a patent-eligible transformation of the blood sample used in determining the level of thiopurine metabolites. *Id.* at 1347. Today, in a brief order granting a petition for writ of certiorari, the Supreme Court vacated the judgment in *Prometheus* and remanded the case back to the Federal Circuit for further consideration in light of yesterday’s *Bilski* decision.

Software Patents

Although the Supreme Court decision in *Bilski* did not directly address the patent-eligibility of software and other computer-implemented methods, the holding in *Bilski* will be closely analyzed for its implications with respect to several district court decisions invalidating such patents under Section 101.

Such decisions include: *Cybersource Corp. v. Retail Decisions, Inc.*, No. C 04-03268 MHP, 2009 U.S. Dist. LEXIS 26056 (N.D. Cal. Mar. 26, 2009) (holding that a claimed process for detecting fraud in a credit card transaction “over the Internet” did not satisfy the machine prong of the Federal Circuit’s “machine-or-transformation” test); *Dealertrack, Inc. v. Huber*, No. CV 06-2335 AG (FMOx), 2009 U.S. Dist. LEXIS 58125 (C.D. Cal. July 7, 2009) (invalidating a patent directed to a computer-based credit application processing system under Section 101); and *Every Penny Counts, Inc. v. Bank of America Corp.*, No. 2:07-cv-042, 2009 U.S. Dist. LEXIS 53626 (M.D. Fla. May 27, 2009) (invalidating under Section 101 a claim drawn to a network comprising, inter alia, “computing means,” asserted against BofA’s “Keep the Change” program).

Patents covering computer-implemented processes in which the implementation of the process on a computer could be considered incidental to the claimed process are particularly vulnerable under Section 101 as drawn to abstract ideas.

Briefing on a number of appeals pending before the Federal Circuit regarding the proper application of Section 101 has been stayed pending the Supreme Court’s decision in *Bilski*, including that in *Every Penny Counts, Inc. v. Bank of America Corporation* and *Cybersource Corp. v. Retail Decisions, Inc.* The Federal Circuit’s resolution of such appeals in light of the Supreme Court’s ruling in *Bilski* will likely shed additional light on the patent-eligibility of computer-implemented methods going forward.

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