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## *In Re Bilski* and Its Impact on Business Method Patents

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The Court of Appeals for the Federal Circuit issued its decision in *In Re Bilski* on October 30, 2008. Although the decision is primarily directed to so-called “business method” patents, and therefore of particular significance to financial services and online retailing communities, it has broader application to all process patents. Business method patents have grown increasingly popular since the Federal Circuit’s 1998 decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*

The lengthy decision, 132 pages in total, included three dissenting opinions totaling 77 pages and a twenty-page concurring opinion.

Understanding the details of the case will help patent holders and applicants interpret the Federal Circuit’s analysis. It will also aid in setting a strategy for an environment in which this ruling remains applicable or until future review by the United States Supreme Court.

## Background

Bernard L. Bilski and Rand A. Warsaw filed a U.S. patent application on April 10, 1997 directed to a method of hedging risk in the field of commodities trading.

During initial examination before the USPTO, all of the claims of the *Bilski* application were rejected based on a “technological arts” analysis. In this regard, the patent examiner found that “the invention is not implemented on a specific apparatus and merely manipulates [an] abstract idea and solves a purely mathematical problem without any limitation to a practical application” and is, therefore, “not directed to the technological arts.”

The examiner’s rejection was appealed to the Board of Patent Appeals and Interferences (“the Board”), which found that the examiner erred for relying on a “technological arts” analysis and requiring the use of a specific piece of equipment. Nevertheless, the Board concluded

that the claims of the *Bilski* application were not directed to statutory subject matter.

The Federal Circuit initially heard oral arguments on October 1, 2007 and, on its own accord, ordered a subsequent *en banc* hearing before its twelve judges. Oral argument before the *en banc* court was held on May 8, 2008. In its October 30, 2008 decision, the Federal Circuit affirmed the Board’s ruling, concluding that the method of hedging risks in commodities trading at issue does not satisfy the patentable subject matter requirements set forth by the Supreme Court. It also confirmed that the so-called “machine-or-transformation test” is the only test of subject matter eligibility for a claimed process, requiring that a patentable process must either (1) be tied to a particular machine or apparatus; or (2) transform an article into another state or thing.

## The Issues

In an order dated February 15, 2008, the Federal Circuit asked counsel to answer a series of questions, with the key issue being whether the commodities hedging process under consideration is a patent-eligible process. To make that determination, the court asked counsel to focus on the patentability of an abstract idea or mental process and the necessity of a method or process to result in a physical transformation of something. Finally, the court asked whether the case that essentially approved the practice of business method patents, *State Street Bank* (and a related case, *AT&T Corp. v. Excel Comms.*) should be overruled.

## Federal Circuit Analysis

The Federal Circuit began its analysis by reiterating that a patentable process cannot claim a fundamental principle, e.g., laws of nature, natural phenomena, or abstract ideas, while recognizing that the application of a fundamental principle to structure or process may be worthy of patent protection. The Federal Circuit noted that the Supreme Court “has

enunciated a definitive test to determine whether a process claim is tailored narrowly enough to encompass only a particular application of a fundamental principle rather than to pre-empt the principle itself.” Thus, the Federal Circuit stated that a “claimed process is surely patent-eligible . . . 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 explained that a claimed process, which involves a fundamental principle, but uses a particular machine or apparatus would not pre-empt uses of the principle that do not also use the specified machine or apparatus in the manner claimed; and the Federal Circuit explained that a claimed process that transforms a particular article to a specified different state or thing by application of a fundamental principle would not pre-empt the use of the principle to (1) transform any other article; (2) transform the same article but in a manner not covered by the claim; or (3) do anything other than transform the specified article.

While it highlighted that “future developments in technology and the sciences may present difficult challenges to the machine-or-transformation test” and that the Supreme Court may later modify or replace this analysis, it reaffirmed that the “machine-or-transformation test” governs patent eligibility for process claims.

The Federal Circuit went on to review other tests, including (1) the *Freeman-Walter-Abele* test; (2) the “useful, concrete, and tangible result test” discussed in *State Street Bank* (though it distinguished *State Street Bank* by noting that the subject process in that case was tied to a particular machine); and (3) the “technological arts test.” The Federal Circuit found all of these other tests to be inadequate, reiterating that the “machine-or-transformation test” is *the* applicable test for patent-eligible subject matter.

To clarify the impact on business methods, the court specifically noted that “business method claims (and indeed all process claims) are

‘subject to the same legal requirements for patentability as applied to any other process or method.’”

#### *Machine or Transformation*

Since the process claim at issue did not limit any process step to any specific machine or apparatus, the court did not address that portion of the analysis. That said, the issue of whether a standard computer qualifies as a “specific machine” for purposes of software and business method patents, the court noted, “We leave to future cases the elaboration of the precise contours of machine implementation, as well as the answers to particular questions, such as whether or when recitation of a computer suffices to tie a process claim to a particular machine.”

With respect to the transformation requirement, it highlighted that a chemical or physical transformation of actual objects or substances, e.g., making waterproof cloth, is patent-eligible. That said, more technologically non-traditional processes are less straightforward.

The court used, as an example, a case in which graphically displaying variances of data from average values was unpatentable, but where X-ray data produced in a two-dimensional field by a scanner was patent-eligible. It held that “the transformation of that raw data into a particular visual depiction of a physical object on a display was sufficient to render that more narrowly-claimed process patent-eligible.” It cautioned, however, that “adding a data-gathering step to an algorithm is insufficient to convert that algorithm into a patent-eligible process.”

In the instant application, the court found that the commodities hedging process as claimed does not transform any item to a different state or thing. Manipulating public or private legal obligations or relationships, or risks in business transactions do not meet the “transformation” test because they are not physical objects or substances, and they are not representative

of physical objects or substances. The transformation of the relationships between the commodity provider, the consumer, and market participants is insufficient. While the applicant claimed that this satisfies the “useful, concrete and tangible results test,” since the court rejected it, there was no merit to this point.

any subsequent action by the Supreme Court. With respect to any applications in process, they should consider adaptive strategies.

## The Prospect of Supreme Court Review

Although the Federal Circuit just issued this decision, there is speculation that the 9-3 *en banc* decision will prompt review by the Supreme Court. Given its level of importance and the number of patents it might affect, not to mention the 39 *amicus curiae* briefs submitted, there is certainly a possibility that the Federal Circuit’s decision will be the subject of Supreme Court review. That said, however, the decision repeatedly mentions high court decisions that support its holding, apparently to avoid subsequent scrutiny from above.

## Evaluation and Planning

The ruling may have a negative impact on pre-revenue and early stage companies that are basing a portion of their valuation on prospective licensing of patented intellectual property and future royalty payments. Accordingly, there may be a disproportionate influence on technology companies.

In addition, even though certain processes may still be patentable, companies that have sought patent protection on business methods to distribute or market that underlying technology may face additional scrutiny or challenge. There will also be many questions about method patents utilizing software, which operates on generic multi-purpose computers since such machines may not be considered “particular” equipment.

Companies should evaluate their patent portfolios to determine whether their intellectual property may be affected by this decision or