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June 29, 2010

NEWS ALERT

Supreme Court Issues Long-Awaited *Bilski* Decision, Business Method Patents Not Categorically Prohibited

In a ruling that surprised many, the Supreme Court held by a 5-4 vote that business methods may be patentable under 35 U.S.C. § 101 in some circumstances. By a unanimous vote, however, the Court has affirmed the PTO and Federal Circuit's rulings rejecting Bilski's patent claims on methods of hedging commodity risks. The Court further unanimously rejected the Federal Circuit's use of the "machine or transformation" test as the sole test under the threshold of section 101 to determine patentable subject matter. Although many had feared--and some had hoped--that all business method patents and many diagnostic and software patents were in jeopardy, the Court's relatively narrow decision did nothing to drastically alter the landscape of patentable subject matter.

The Supreme Court affirmed that the patent statute offers patent protection for "any new and useful process, machine, manufacture, or composition of matter." Prior to the Supreme Court's decision in *Bilski*, the Federal Circuit had ruled that a process is patentable if, and only if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing. Although the majority opinion refused to define the term "process", it did write that this "machine-or-transformation test" developed by the Federal Circuit does not define what is (and is not) a patentable process. Rather, the Court held that the machine-or-transformation test offers "a useful and important clue, an investigative tool, for determining whether some claimed inventions are processes under §101," but "is not the sole test for deciding whether an invention is a patent-eligible process." As a "clue," the machine-or-transformation test likely correlates with the existence of patentable subject matter. After the Court's decision, however, some patent claims that are not tied to a machine or transformation will still be patentable and other patent claims that are tied to a machine or transformation will still be ineligible. Further refinement of these principles is sure to come as the courts work to apply the Supreme Court's decision to your current and future innovations.

If you would like more information, we encourage you to read the attached paper that we prepared, discussing this case in greater detail.

Hayes Soloway PC continues to monitor changes to the practice of intellectual property law in the United States and will strive to keep you informed. Please contact us directly if you have any further questions or if you wish to enlist our services.

Supreme Court Issues Long-Awaited *Bilski* Decision
Narrow Ruling Spares Business Method Patents, but Not Bilski

In ruling that surprised many, the Supreme Court held by a 5-4 vote that business methods may be patentable under 35 U.S.C. § 101 in some circumstances. By a unanimous vote, however, the Court has affirmed the PTO and Federal Circuit's rulings rejecting Bilski's patent claims on methods of hedging commodity risks. The Court further unanimously rejected the Federal Circuit's use of the "machine or transformation" test as the sole test for patentability under the threshold of section 101 to determine patentable subject matter. Although many had feared--and some had hoped--that all business method patents and many diagnostic and software patents were in jeopardy, the Court's relatively narrow decision did nothing to drastically alter the landscape of patentable subject matter. Further clarification from the Federal Circuit is sure to follow in the coming months and years.

Section 101 of the Patent Act of 1952, 35 U.S.C. § 101, directs the Patent and Trademark Office (PTO) to issue patents to "[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." Even if a claimed invention qualifies as a "process, machine, manufacture, or composition of matter" under § 101, it must also satisfy "the conditions and requirements of this title," including novelty under 35 U.S.C. § 102, nonobviousness under 35 U.S.C. §103, and a full and particular description, under 35 U.S.C. §112. Because Bilski's patent application claimed a method of hedging risk, the Court's emphasis was focused on the definition of a "process" under the statute.

The statute predates the formation of the biotechnology and software industries, and accordingly, courts in the modern age have struggled to define when inventors may patent less physical inventions such as inventions involving software, advanced diagnostic medicine techniques, and inventions based on linear programming, data compression, and the manipulation of digital signals.

Since the enactment of the Patent Act of 1952, patentable subject matter has been given a wide scope with three specific exceptions: "laws of nature, physical phenomena, and abstract ideas." *Diamond* v. *Chakrabarty*, 447 U. S. 303, 308-309 (1980). The "abstract ideas" exception has been clarified by three Supreme Court cases, relied upon heavily in the Court's decision in In re Bilski:

In *Gottschalk* v. *Benson*, 409 U. S. 63, 70 (1972), the Court considered whether a patent application for an algorithm to convert binary-coded decimal numerals into pure binary code was a "process" under §101. The Court first explained that "[a] principle, in the abstract, is a fundamental truth; an original cause; a motive; these cannot be patented, as no one can claim in either of them an exclusive right." The Court then held the application at issue was not a "process," but an unpatentable abstract idea. "It is conceded that one may not patent an idea. But in practical effect that would be the result if the formula for converting . . . numerals to pure binary numerals were patented in this case." A contrary holding "would wholly pre-empt the mathematical formula and in practical effect would be a patent on the algorithm itself."

In *Parker v. Flook*, 437 U. S. 584 (1978), the Court considered the next logical step after *Benson*. The applicant there attempted to patent a procedure for monitoring the conditions during

the catalytic conversion process in the petrochemical and oil-refining industries. The application's only innovation was reliance on a mathematical algorithm. *Flook* held the invention was not a patentable "process." The Court conceded the invention at issue, unlike the algorithm in *Benson*, had been limited so that it could still be freely used outside the petrochemical and oil-refining industries. Nevertheless, *Flook* rejected "[t]he notion that post-solution activity, no matter how conventional or obvious in itself, can transform an unpatentable principle into a patentable process." The Court concluded that the process at issue there was "unpatentable under §101, not because it contain[ed] a mathematical algorithm as one component, but because once that algorithm [wa]s assumed to be within the prior art, the application, considered as a whole, contain[ed] no patentable invention." As the Court later explained, *Flook* stands for the proposition that the prohibition against patenting abstract ideas "cannot be circumvented by attempting to limit the use of the formula to a particular technological environment" or adding "insignificant post solution activity." *Diamond v. Diehr*, 450 U. S. 175, 191-192 (1981).

Finally, in *Diamon v. Diehr*, the Court established a limitation on the principles articulated in *Benson* and *Flook*. The application in *Diehr* claimed a previously unknown method for "molding raw, uncured synthetic rubber into cured precision products," using a mathematical formula to complete some of its several steps by way of a computer. *Diehr* explained that while an abstract idea, law of nature, or mathematical formula could not be patented, "an *application* of a law of nature or mathematical formula to a known structure or process may well be deserving of patent protection." *Diehr* emphasized the need to consider the invention as a whole, rather than "dissect[ing] the claims into old and new elements and then . . . ignor[ing] the presence of the old elements in the analysis." Finally, the Court concluded that because the claim was not "an attempt to patent a mathematical formula, but rather [was] an industrial process for the molding of rubber products," it fell within§101's patentable subject matter.

In 1998, the Federal Circuit built on the foundation laid by Benson, Flook and Dieh and explicitly held that a piece of software could be patentable. *State Street Bank & Trust Co.* v. *Signature Financial Group, Inc.*, 149 F. 3d 1368 (1998). While noting that pure mathematical algorithms are not patentable subject matter to the extent that they are merely abstract ideas, the "transformation of data . . . by a machine . . . into a final share price, constitutes a practical application of a mathematical algorithm, formula or calculation," and was thus patentable subject matter "because it produces a useful, concrete and tangible result." The Federal Circuit further noted that "[The business method exception] is . . . an unwarranted encumbrance to the definition of statutory subject matter in § 101, that [should] be discarded as error-prone, redundant, and obsolete." State Street Bank opened the door to patent protection on a wider variety of innovations, especially in the fields of business methods and software.

The Bilski Case:

Bilski's application sought patent protection for a claimed invention that explains how buyers and sellers of commodities in the energy market can protect, or hedge, against the risk of price changes. For example, Claim 1 described a series of steps instructing how to hedge risk. Claim 1 consists of the following steps: "(a) initiating a series of transactions between said commodity provider and consumers of said commoditywherein said consumers purchase said

commodity at afixed rate based upon historical averages, said fixedrate corresponding to a risk position of said consumers; "(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."

The patent examiner rejected Bilski's application, on the grounds that the claimed invention merely manipulates an abstract idea and solves a purely mathematical problem without any limitation to a practical application. The Board of Patent Appeals and Interferences affirmed, concluding that the application involved only mental steps that do not transform physical matter and was directed to an abstract idea.

The United States Court of Appeals for the Federal Circuit heard the case en banc and affirmed. The court rejected its prior test for determining whether a claimed invention was a patentable "process" under §101—whether it produces a "'useful, concrete, and tangible result'"—as articulated in *State Street Bank* and in *AT&T Corp.* v. *Excel Communications, Inc.*, 172 F. 3d 1352, 1357 (1999). See *In re Bilski*, 545 F. 3d 943, 959–960, and n. 19 (CA Fed. 2008) (en banc). The court held that "[a] claimed process is surely patent eligible under §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 court concluded this "machine-or-transformation test" is "the sole test governing §101 analyses," and thus the "test for determining patent eligibility of a process under §101". Applying the machine-or-transformation test, the court held that petitioners' application was not patent eligible.

The U.S. Supreme Court eventually affirms the Appeals Court's decision, but on very different grounds. The Court relies on the "ordinary, contemporary, common meaning," of the definitional terms "process, art or method" and rejects tying those terms to a machine or to the transformation of an article. Justice Kennedy's majority upholds the machine-or-transformation test as "a useful and important clue, an investigative tool," for determining patentability under § 101, but not the sole test for deciding whether an invention is a patent eligible process.

Similarly, the Court relies on the "ordinary, contemporary, common meaning," of "method" to reject a categorical exclusion of business methods. The Court further argues that 35 U.S.C. § 273(a)(3), allowing a prior use defense to business method patents, compels an interpretation that "a business method is simply one kind of "method" that is, at least in some circumstances, eligible for patenting under §101." Any conclusion otherwise would render § 273 meaningless.

Notwithstanding the Majority's finding that some business method patents may satisfy the requirements of § 101 patentability, all nine justices agreed that Bilski's method of hedging risk was not patentable because it is an abstract idea "just like the algorithms at issue in *Benson* and *Flook*."

> The concept of hedging, described in claim 1 and reduced to a mathematical formula in claim 4, is an unpatentable abstract idea, just like the algorithms at issue in *Benson* and *Flook*. Allowing petitioners to patent risk hedging would

> preempt use of this approach in all fields, and would effectively grant a monopoly over an abstract idea.
>
> Petitioners' remaining claims are broad examples of how hedging can be used in commodities and energy markets. *Flook* established that limiting an abstract idea to one field of use or adding token post-solution components did not make the concept patentable. That is exactly what the remaining claims in petitioners' application do. These claims attempt to patent the use of the abstract idea of hedging risk in the energy market and then instruct the use of well-known random analysis techniques to help establish some of the inputs into the equation. Indeed, these claims add even less to the underlying abstract principle than the invention in *Flook* did, for the *Flook* invention was at least directed to the narrower domain of signaling dangers in operating a catalytic converter.

Beyond its basic holdings, the Court was fractured. Justice Kennedy's lead opinion made additional comments regarding applying the language of § 101 in the information age with respect to emerging technologies. The Kennedy group, which included Chief Justice Roberts and Justices Thomas and Alito, specifically state that "Section 101's terms suggest that new technologies may call for new inquiries" as technology evolves. Those views commanded only four votes, however, with Justice Scalia declining to adopt such a dynamic interpretation.

Justice Stevens, joined by Justices Ginsburg, Breyer and Sotomayor, wrote an opinion that concurred in the judgment that Bilski's claims were unpatentable, but on different grounds. Those four Justices agreed that the "machine or transformation" test was not the sole test for patentability under Section 101, but would have held that business methods are inherently unpatentable.

Justice Breyer also wrote a short concurrence highlighting the Court's unanimous agreement on several issues, including the unpatentability of abstract ideas and the usefulness but non-exclusivity of the "machine or transformation" test.

The majority opinion neither endorses nor rejects the standard used by the Federal Circuit before *Bilski* and articulated in *State Street* — writing instead that "nothing in today's opinion should be read as endorsing interpretations of §101 that the Court of Appeals for the Federal Circuit has used in the past. See, e.g., *State Street*, 149 F. 3d, at 1373; *AT&T Corp*., 172 F. 3d, at 1357." Although not rejected by the majority opinion, it is clear that the broad "useful, concrete, and tangible result" test to determine patentability is dead. That test is conclusively rejected by a majority created by the combining the two concurring opinions in *Bilski*.

The two concurring opinions in *Bilski* both explicitly reject the Useful-Concrete-And-Tangible-Result test of *State Street*. Justice Stevens writes that "it would be a grave mistake to assume that anything with a 'useful, concrete and tangible result,' may be patented, and Justice Breyer reiterated his prior statement that "if taken literally, the statement [that anything which produces a useful, concrete, and tangible result, is patentable] would cover instances where this court has held the contrary." The two concurrences are in agreement on this point and are signed by five Supreme Court Justices — leading to a second majority on that particular point.

Of course, in its *In re Bilksi* decision, the Federal Circuit already repudiated *State Street* as inadequate and "insufficient to determine whether a claim is patent-eligible under § 101." Cumulatively, this means that the broadest notion of patentable subject matter as represented by *State Street* is not the law. Although not "*the test*" it appears that the USPTO will continue to use the machine-or-transformation test as a "tool" for determining whether particular process claims fit within Section 101. A recent Post-*Bilski* notice to examiners indicated as much:

> Examiners should continue to examine patent applications for compliance with section 101 using the existing guidance concerning the machine-or-transformation test as a tool for determining whether the claimed invention is a process under section 101. If a claimed method meets the machine-or-transformation test, the method is likely patent eligible under section 101 unless there is a clear indication that the method is directed to an abstract idea. If a claimed method does not meet the machine-or-transformation test, the examiner should reject the claim under section 101 unless there is a clear indication that the method is not directed to an abstract idea. If a claim is rejected under section 101 on the basis that it is drawn to an abstract idea, the applicant then has the opportunity to explain why the claimed method is not drawn to an abstract idea.

Essentially, 35 USC 101 offers patent protection for "any new and useful process, machine, manufacture, or composition of matter." Although the majority opinion refused to define the term process, it did write that the machine-or-transformation test developed by the Federal Circuit *does not* define what is (and is not) a patentable process. Rather, the Court held that the machine-or-transformation offers "a useful and important clue, an investigative tool, for determining whether some claimed inventions are processes under §101. The machine-or-transformation test is not the sole test for deciding whether an invention is a patent-eligible process." As a "clue," the machine-or-transformation test likely correlates with the existence of patentable subject matter. However, some patent claims that fail the test will still be patentable and other patent claims that pass the test will still be ineligible.