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Supreme Court Confirms The Patentability of Business Methods, But Sets A Standard That Many Such Patents May Not Satisfy

In its much-anticipated decision in *Bilski v. Kappos*[1] on the patentability of business methods, the Supreme Court ruled earlier this week that a method of hedging risk in the field of commodities trading cannot be patented, but it reached that result through an approach that differed from that of the court below. And while a five-justice majority agreed that business methods cannot be categorically excluded from what is patentable, the four other justices would have so held. And even the majority's reasoning, in explaining why Bilski's hedging technique is not patentable, suggests that many other business method inventions may face a similar fate.

All nine justices viewed Bilski's claimed invention as merely an "abstract idea" and hence ineligible for patenting. And all agreed that while the Federal Circuit Court of Appeals was wrong to rule that its "machine-or-transformation" standard is the sole test for patentability of processes, they also affirmed that this standard remains a highly important "clue." But the Court split sharply on whether business methods can be patented. Justice Kennedy wrote for the majority that business methods cannot be categorically excluded from patenting. The other four justices, joining in the last opinion Justice Stevens authored before retiring, thought the "wiser course" would be to hold that "business methods are not patentable." Though the two camps used barbed words about each other, the difference between them may not be great in practice. As discussed below, many business methods – including intangible processes such as trading strategies – likely would fail the "abstract idea" standard that Justice Kennedy's majority opinion applied.

Bilski illustrates that patent law is never more metaphysical or nebulous than when it seeks to define the outer bounds of what can be patented. Bilski sought to patent a hedging technique for commodities: to address the exposure that coal mining companies have to drops in the price of coal and that coal-consuming power plants have to increases in price, an intermediary would enter into fixed price contracts with both sides. Everyone who

[1] No. 08-964 (S. Ct. June 28, 2010) (Kennedy, J.). Citations are to the slip opinion, available at http://www.supremecourt.gov/opinions/09pdf/08-964.pdf

considered this claimed invention – from the Patent and Trademark Office to the Federal Circuit to the Supreme Court – agreed it did not qualify for patenting. But the challenge is to articulate why.

The Federal Circuit used *Bilski* to revisit the thorny questions of when and whether business methods can be patented. Years earlier it had launched the growth of these patents by holding in *State Street*[2] that anything producing a "useful, concrete and tangible result" would qualify. Since then thousands of business method patents have issued, largely in the fields of financial services, insurance, consulting, software and e-commerce, attracting both criticism and support from different quarters. Perceiving a need to sharpen the standards for assessing these inventions, the Federal Circuit considered Bilski's case *en banc* and adopted a new "machine-or-transformation" test under which, to be eligible for patenting, a claimed process must either 1) be tied to a machine or apparatus, or (2) transform an article into a different state or thing.[3] Because Bilski's hedging strategy met neither requirement, it did not merit a patent.

The Federal Circuit believed its "machine-or-transformation" standard was faithful to Supreme Court jurisprudence. But the Supreme Court disagreed. Justice Kennedy wrote for the majority that the machine-or-transformation test is a "useful and important clue" for assessing patentability, but cannot be the "sole test." (Op. at 8). The majority based its ruling primarily on its belief that the Patent Act's text impose no such limitation. But it also expressed concern that in the dawning "Information Age," the machine-or-transformation test might prove too rigid and limiting:

> 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. (Op. at 9).

Turning to whether business methods can be patented, the majority acknowledged that "some business method patents raise special problems in terms of vagueness and suspect validity," but nevertheless held 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." (Op. at 12). This obviously is not a rousing endorsement of business method patents, but not the death knell that Justice Stevens and three other justices wished to ring for them.

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

3 *In re Bilski*, 545 F.3d 943, 961 (Fed. Cir. 2008).

Having rejected the machine-or-transformation test as the sole standard, the majority resolved the case before it by returning to first principles. The Court's jurisprudence long has held (though the Patent Act does not expressly state) that "laws of nature, physical phenomena and abstract ideas" cannot be patented. Reviewing its precedents rejecting certain claimed inventions as abstract ideas, such as an algorithm to convert binary-coded decimal numerals into pure binary code, the majority ruled, without much explanation, that Bilski's hedging technique fell into the prohibited category of abstract ideas. Though the majority did not expressly say so, the fact that the claimed invention involved intangible principles not tied to any machine or the transformation of any article likely led to its classification as an unpatentable abstract idea. Thus, the Court held that "[a]llowing [Bilski] to patent risk hedging would preempt use of this approach in all fields, and would effectively grant a monopoly over an abstract idea." (Op. at 15).

Justice Stevens and three others (Breyer, Ginsburg and Sotomayor) agreed with the majority opinion's result, but not its approach. Based largely on a historical review reaching back to English practice that served as the backdrop for the Constitution's Patent Clause, Justice Stevens concluded that methods of doing business were never meant to be patented. (Stevens Concurrence at 15-34). Hence, these four justices would have discarded business method patents altogether. (*Id.* at 2). And though they concurred in the majority's result, they were not impressed by the analysis:

> The Court, in sum, never provides a satisfying account of what constitutes an unpatentable abstract idea. Indeed, the Court does not even explain if it is using the machine-or-transformation criteria. The Court essentially asserts its conclusion that petitioners' application claims an abstract idea. This mode of analysis (or lack thereof) may have led to the correct outcome in this case, but it also means that the Court's musings on this issue stand for very little. (*Id.* at 9).

Finally, a sort of "peace commission" concurrence joined by delegates from the two factions – Justice Scalia from the Kennedy camp and Justice Breyer from the Stevens camp – sought to help weary readers by highlighting the areas where, in their view, the Kennedy and Stevens opinions share common ground. They wrote that the Patent Act's scope of patentable subject matter is broad, but "not without limit;" that the machine-or-transformation test was the most important "clue" for assessing the patentability of a process, but not the sole test; and that the "useful, concrete and tangible result" standard that the Federal Circuit had articulated years ago in *State Street* was unacceptable. (Breyer and Scalia Concurrence at 2-4). Thus, they concluded, "in reemphasizing that the 'machine-or-transformation' test is not necessarily the *sole* test of patentability, the Court intends neither to deemphasize the test's usefulness nor to suggest that many patentable processes lie beyond its reach." (*Id*. at 4 (emphasis in original)).

What is the upshot of all this analysis? The headline that *Bilski* sustains business method patents is understandable, but may be misleading. Business method patents certainly are not dead, as the Stevens camp wished. And an inventor of a "process" that is not tied to a machine and does not transform an article theoretically can argue for a patent. But owners and proponents of business method patents should not be overly encouraged. Of particular interest to Wall Street firms, claimed inventions that are reducible to algorithms and mathematical formulae or are directed solely to abstract strategies such as trading or hedging techniques are unlikely to qualify for patent protection. These inventions face an uphill battle if they do not meet the machine-or-transformation standard, and they likely would fall prey to the *Bilski* majority's reinvigorated "abstract idea" analysis.

For further information about *Bilski* or any of the issues discussed above, please 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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