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ALERT MEMORANDUM

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Supreme Court Curbs Patentability of Computerized Business Methods

On June 19, the U.S. Supreme Court unanimously decided in Alice Corporation Pty. Ltd. v. CLS Bank International, et al.[1] that a computer-implemented business method for using an intermediary to reduce risks associated with settling financial transactions is not eligible for patenting. More broadly, the Court held that abstract ideas, which are unpatentable, are not limited to preexisting, fundamental truths that exist apart from human action and that, when an invention involves an abstract idea, merely requiring generic computer implementation of that idea does not transform it into a patent-eligible invention. This holding is good news for Wall Street firms and other companies in the financial industry that have been seeking ways to fend off patent assertions, often by non-practicing entities or "patent trolls," involving computerized business methods.

Legal Background

The CLS Bank decision was much anticipated, as it presented the Court with another opportunity to clarify the scope of patent-eligible subject matter for business methods generally and computer-implemented methods in particular, which has been the subject of much debate over recent years. Section 101 of the U.S. Patent Act provides that any new and useful "process, machine, manufacture, or composition of matter" may be patented. The Court has long held that this provision contains an implicit exception: laws of nature, natural phenomena and abstract ideas are not patentable. However, the scope of the 'abstract ideas' exception, as it applies to business methods, has never been clearly delineated. The Court's most recent pronouncement on business methods was in 2010 in Bilski v. Kappos,[2] in which it invalidated a patent on a (non-computerized) method of hedging against the financial risk of price fluctuations as an unpatentable abstract idea, but without providing concrete guidance on the borderline between ineligible abstract ideas and other business methods. The Federal Circuit has since attempted to apply the Bilski reasoning to determine if patent claims are too abstract to be patentable, but has pursued inconsistent approaches in different cases, resulting in significant legal uncertainty.

Factual and Procedural Background

Alice Corporation ("Alice") owns patents on a method relating to a computerized trading platform for exchanging financial obligations, in which a third party settles the obligations so as to mitigate "settlement risk" (the risk that one of the exchanging parties may not perform the exchange). The patented invention includes "shadow accounts" that link to the parties' bank

[1] No. 13-298 (S. Ct. June 19, 2014) (Thomas, J.) Citations are to the slip opinion, available at http://www.supremecourt.gov/opinions/13pdf/13-298_7lh8.pdf.

[2] Bilski v. Kappos, 561 U.S. 593 (2010).

accounts, are adjusted in real time and permit transactions to proceed only when the shadow balances remain above zero. The patents in suit claim the method for exchanging obligations, a computer system for carrying out the method and a medium containing the relevant software code.

CLS Bank International and CLS Services Ltd (together "CLS Bank") operate a network that facilitates currency transactions. CLS Bank sued Alice in 2007, seeking a declaratory judgment that Alice's patents were invalid, unenforceable or not infringed by CLS Bank. Alice counterclaimed, asserting infringement. On summary judgment, the U.S. District Court for the District of Columbia, relying on Bilski, held that Alice's patent claims were invalid as they merely recited a patent-ineligible abstract idea.[3] A three-judge panel of the Federal Circuit initially reversed the decision, finding that it was not "manifestly evident" that the claims were drawn to an abstract idea.[4] Upon rehearing *en banc*, in May 2013, a splintered Federal Circuit issued a one-paragraph *per curiam* opinion affirming the trial court's holding that the claims were not directed to patent-eligible subject matter.[5] The judges could not reach consensus on the proper test for patent eligibility, but a five-member plurality agreed that the claims were drawn to an abstract idea and that the use of a computer to maintain, adjust and reconcile shadow accounts added nothing of substance to that idea.[6]

The Supreme Court's Opinion

In a unanimous opinion authored by Justice Thomas, the Court began by discussing the fundamental tension in patent law between patent-eligible innovations and patent-ineligible abstract ideas, a tension that arises out of the competing desires to grant a monopoly for true inventive activity while avoiding the grant of a monopoly over laws of nature, natural phenomena and abstract ideas. The Court explained that patent law must not inhibit further discovery by "tying up" the future use of the "building blocks of human ingenuity;" at the same time, the Court noted that it must "tread carefully in construing this exclusionary principle lest it swallow all of patent law." (Op. at 6.)

The Court then applied the two-step framework it had articulated in 2012 in Mayo Collaborative Services v. Prometheus Laboratories, Inc., a biotechnology case, for distinguishing patents that claim "laws of nature, natural phenomena, and abstract ideas" from those that claim "patent-eligible applications of those concepts." (Op. at 7.) Under Mayo, it must first be determined whether the invention is drawn to a patent-ineligible concept (a law of nature, natural phenomenon or abstract idea). If the invention is drawn to a patent-ineligible concept, the Court then asks whether the elements of each claim, considered "individually and as an ordered combination," involve an "inventive concept" that "transform[s]" the nature of the claim into a patent-eligible invention. (Op. at 7.)

[3] CLS Bank Int'l v. Alice Corp., 768 F. Supp. 2d 221, 252 (D.D.C. 2011).

[4] CLS Bank Int'l v. Alice Corp., 685 F.3d 1341, 1352, 1356 (Fed. Cir. 2012).

[5] CLS Bank Int'l v. Alice Corp., 717 F. 3d 1269, 1273 (Fed. Cir. 2013) (en banc).

[6] *Id.* at 1286.

Applying the Mayo framework to Alice's patent claims, the Court first found that the invention at issue is drawn to an abstract idea, specifically, "intermediated settlement, *i.e.*, the use of a third party to mitigate settlement risk," which the Court observed is a "fundamental economic practice long prevalent in our system of commerce." (Op. at 9). The Court rejected Alice's attempt to limit the 'abstract ideas' exception to those preexisting fundamental truths that exist in principle apart from any human action, such as mathematical formulas, but declined to elaborate the precise contours of the 'abstract ideas' category. (Op. at 9-10.) The Court instead simply recognized that there is no meaningful distinction between the concept of intermediated settlement and the concept of risk hedging, for which it had invalidated the patent in Bilski.

The Court then proceeded with the second step of the Mayo test, determining whether the claims nonetheless included an "inventive concept" that would render them patentable. The Court found that they did not, rejecting Alice's argument that the claims are patent eligible because they require a "substantial and meaningful role" for a computer. The Court held that "[s]tating an abstract idea while adding the words 'apply it with a computer'" is not enough for patent eligibility. (Op. at 13.) With respect to the claims-in-suit, the Court observed that using a computer to create and maintain shadow accounts "amounts to electronic recordkeeping—one of the most basic functions of a computer," and the same is true for using a computer to obtain data, adjust account balances and issue automated instructions—all are "well-understood, routine, conventional" and "generic" computer functions. (Op. at 15.) The Court noted that "[t]he method claims do not, for example, purport to improve the functionality of the computer itself …[or] effect an improvement in any other technology or technical field," thereby signaling certain types of computer implementations that involve an "inventive concept" sufficient to transform the abstract idea into a patent-eligible invention.

Similarly, the Court found that the patent claims covering a computer system and a computer-readable medium added nothing of substance to the underlying abstract idea and were therefore patent ineligible as well. The Court noted that, although the system claims recite specific hardware, that hardware —"a 'data processing system' with a 'communications controller' and 'data storage unit'"—is purely functional and generic. Because the system claims merely "recite a handful of generic computer components configured to implement the same idea" as in the method claims, to hold them patentable would be to allow patent eligibility to "depend simply on the draftsman's art." (Op. at 16-17.)

Interestingly, Justice Sotomayor issued a concurring opinion, joined by Justices Ginsburg and Breyer, voicing support for the abolishment of all business method patents, irrespective of how the method is implemented, echoing the concurrence they joined in Bilski. (Sotomayor Concurrence at 1.)

Implications of the Court's Decision

The Court's ruling has two major implications. First, it significantly curbs the patentability of computerized business methods. The Court rejected the notion that the 'abstract ideas' exclusion from patentability is confined to "preexisting, fundamental truths" that exist apart from any human action, suggesting instead that concepts that are fundamental economic practices or longstanding commercial practices, such as the ones in Bilski and in CLS Bank, will be deemed

patent-ineligible abstract ideas. The Court also made clear that an implementation of an otherwise patent-ineligible abstract idea such as a business method on or via a computer does not necessarily transform that idea into a patent-eligible invention.

Overall, the ruling provides significant ammunition to entities accused of infringing computerized business method patents. That is good news for Wall Street firms and other companies in the financial industry, which have been seeking ways to fend off patent assertions, often by non-practicing entities or "patent trolls," involving computer-implemented inventions of the type rejected in CLS Bank. These asserting entities will now face an uphill battle to show that the use of a computer does more than merely providing generic or routine computer functions, and thus contributes to innovation and renders the abstract idea patent-eligible.

However, by refusing to rule that business methods are categorically ineligible for patent protection (as proposed by Justice Sotomayor's concurring opinion), the Court acknowledged that some inventions involving business methods may represent technological or technical innovations that merit patent protection, *e.g.*, if they are implemented on a computer in a manner that advances technology. In this context, it is inopportune that the Court did not delineate more clearly the border line between ineligible abstract ideas and other business methods.

Second, since CLS Bank makes clear that software patents and other computer-implemented inventions can still be protected by patents under U.S. law, the Court's decision should nevertheless be viewed positively by the software industry. A computer-implemented invention that does not involve an abstract idea remains unaffected by CLS Bank; and a computer-implemented invention that does involve an abstract idea can still be patented if it contains an inventive concept, and does more than just instruct the user to implement the idea on a generic computer. For example, computer-implemented inventions that improve the functioning of the computer itself or effect an improvement in any other technology or technical field are patent-eligible (even if they involve an abstract idea). In this respect, the Court also brings U.S. patent law closer to European law (though material differences remain), further enhancing legal certainty for patent owners and potential defendants alike.

In sum, CLS Bank is yet another in a line of Supreme Court rulings (including Bilski and Mayo) that narrow patent eligibility by making it more difficult to patent abstract ideas. It can also be seen as an expression of the Supreme Court's sensitivity to the concerns voiced by many, including Congress and the President, that the U.S. patent system needs to be changed in order to ensure that it promotes innovation rather than impeding it, as many contend it does by granting too much power and too broad a monopoly to holders of patents claiming trivial subject matter.

If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under "Intellectual Property" in the "Practices" section of our website at http://www.clearygottlieb.com.

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