



Patents under Pressure

The battle over business-method patents heads to court in what may be a landmark decision.

[Marie Leone](#), CFO Magazine

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Anyone who has ever made a purchase on Amazon.com using its "1-Click" checkout option can't help but be impressed by the convenience. Register your personal, credit, and delivery information once and all subsequent purchases require only a single mouse-click. The concept is simple, ingenious — and contentious. For years various parties have argued over who actually invented 1-Click. But that issue soon may be moot as the legal battle shifts to another front.

Amazon's shopper-friendly technique is based on a tedious, behind-the-scenes set of instructions described in a 931-word business-method patent claim. U.S. Patent No. 5,960,411 ultimately protects the process of "fulfilling [a] generated order to complete purchase of the item whereby the item is ordered without using a shopping cart ordering model...." It is one of more than 6,000 such patents that have been issued by the U.S. Patent and Trademark Office (USPTO) in just the past decade.

But business-method patents, including Amazon's 1-Click process, H&R Block's tax-refund system, Priceline.com's name-your-price airline tickets, and Netflix's movie-rental process, may not enjoy patent protection for long. On May 8, the U.S. Court of Appeals for the Federal Circuit will hear *In Re Bernard L. Bilski and Rand A. Warsaw*, which could determine whether business-process methods should be protected by patent law. Currently the courts — including the U.S. Supreme Court — have not been clear about whether a process that has no tangible physical form, or innovative physical steps, should be patentable. As a result, business-method and software patents have been the focal point of several high-profile lawsuits. The *Bilski* case may set a new and important precedent.

What are potentially at stake are the thousands of business-process patents that have been issued since the 1998 landmark *State Street Bank & Trust Co. v. Signature Financial Group Inc.* decision — as well as the associated royalties. In that case, the court of appeals — the same court hearing *Bilski* — held that such patents were valid as long as the process yielded "a useful, concrete, and tangible result." That ruling triggered a flood of new applications, says Wynn Coggins, group director of business-method patents at the USPTO. Indeed, the year *State Street* was handed down, 1,400 business-method patent applications were filed and 306 patents were issued. Applications shot up to more than 3,000 in 1999, and by last year more than 11,000 inventors filed for protection, with 1,330 business-method patents issued.

That deluge has put a strain on the resources at the USPTO and "adversely affect[ed] the quality of issued patents," maintains Michael Meurer, associate professor of law at Boston University School of Law, in the *Journal of Law & Policy*. The double whammy of more patents and sinking quality also hinders start-up companies from entering the market for fear that they will be accused of infringing on patents that are "obvious" in nature but still protected by law.

The hope is that a new decision will clarify where to draw the line on patentable subject matter, says Ben Klemens, executive director of End Software Patents, an advocacy group. And if *Bilski* doesn't decide the matter, says Paul Devinsky, an intellectual-property attorney at McDermott Will & Emery, then the business-method patent issue will be "all teed up for the Supreme Court."

Getting Physical

It's not the specifics of the *Bilski* case that have patent observers riveted (the case hinges on whether the USPTO was correct in rejecting a patent application for a novel hedging strategy that linked natural-gas prices and erratic swings in the weather). Rather, as part of that case

the appeals court has asked interested parties to address several larger questions about business-method patents, including whether the justices should revisit *State Street*. In effect, the *Bilski* case is synonymous with *State Street* because the court has invited interested parties to comment on *State Street* as part of *Bilski*.

The appeals court judges will hear the *Bilski* case en banc, meaning that all 12 justices will be involved, rather than the usual 3-judge panel. Observers believe "the federal circuit is trying to address broader issues than just whether Bilski and Warsaw get their patent," says Donald Ware, an intellectual-property attorney with Foley Hoag, a Boston law firm that filed an amicus brief on *Bilski*.

The issue of what constitutes physicalness is front and center. Before *State Street*, the patent office and courts generally agreed that a patentable process had to produce some sort of physical change or activity, such as molding rubber into a tire or mixing chemicals to produce the glue for a Post-it note. In fact, when the patent office rejected the Bilski patent, it did so because the process did not result in a "physical transformation, or any electrical, chemical, or mechanical act."

But the courts have not been consistent in their rulings, particularly with regard to software patents. For instance, the Supreme Court has ruled that some software patents are akin to a pure mental process and therefore unpatentable. But the federal appeals court sanctions software patents because it says they combine a mental process (computer code) with physical steps (causing a computer to process data), thereby making it patentable material. Revisiting the *State Street* decision, which involved a patent for a computerized accounting system for managing mutual funds, may finally yield a clear answer regarding what type of physical change or activity is needed to establish patentability.

Infringement Festival

One side benefit of *Bilski* may be some discussion on which processes are considered ordinary and which are not. While the case won't rule on it specifically, the term *obvious* refers to a patent claim that could have been developed by a person with ordinary skill and knowledge in a particular field using existing information. Many times, says Klemens, smaller companies infringe on business-method and software patents without even knowing it, because the patents have been awarded to commonplace processes.

Consider the following patent, a method for compressing audio/visual files and posting them on Websites, which is held by Global Patent Holdings. The patent is not classified as a business method by the USPTO, but rather as an electrical computer-and-digital-processing system. Still, it is often held up as an example of what can go wrong with the patent system. Since August 2007, Global Patent Holdings has sued a long list of companies — including Apple, Caterpillar, CDW, pro football's Green Bay Packers, Motorola, and OfficeMax — for downloading to their respective Websites digital images known as jpegs, and thus allegedly infringing on the patent.

Such infringements could mean that a company is forced to pay damages, back royalties, and other fees, says Rachael Schwartz, a senior manager at ipCapital Group, an intellectual-property consultancy based in Williston, Vermont. Consequently, one "real-world implication" of overturning *State Street*, says Klemens, is that the risk of liability will be lessened, especially for smaller companies.

Cold-War Tactics

Companies that hold business-method patents view the *State Street* decision and *Bilski* differently. For instance, Michael Monahan, CFO of Pitney Bowes, notes that his company holds many business-method patents, emphasizing that "new and improved business processes are important to our company." In his view, current law provides all the tools necessary to determine whether a business method is patentable. He asserts that a business process that transforms a state of matter — including informational matter — "is patentable as long as it passes the existing legal tests, including being useful, novel, and not obvious in view of the state of the art."

On the other hand, U.S. patent leader IBM always believed that nontechnological business methods should not be patentable, says company spokesman Ari Fishkind. But after the *State Street* decision, the company continued to pursue such patents, "mostly as a defensive measure."

One reason a company plays defense with patents is to achieve what some experts describe as an uneasy *détente* with companies that hold similar patents. The unspoken deal is that each company is free to pursue its business without being hauled into court by the other under an allegation of patent infringement. In that way, there is no risk of a court overturning either patent.

But in recent years, IBM has become increasingly concerned about what it believes to be unwarranted issuance of business-method patents. In an effort to encourage fellow inventors to focus on more-technologically focused inventions, IBM released approximately half of its 200 or so business-method patents into the public domain, including patents held on a method for bidding on multiple online auctions simultaneously and another for inspecting the release of escrow funds to prevent fraud. The patents represent just a tiny fraction of IBM's worldwide portfolio of 42,000 patents, a collection that, combined with other intellectual property such as trademarks and copyrights, generates more than \$1 billion in revenue annually.

To Big Blue, the release had little impact because the company never enforced the patents, believing the legal underpinnings were suspect. "We removed [business-method patents] as a focus area, and encourage others to do the same, [because] we feel that true innovation and quality lie in other types of patents," such as software and hardware, notes IBM's Fishkind. What's more, IBM has pledged hundreds of patents to the open-source, health-care, education, and environmental communities.

Secret Weapon

Not all companies take such a generous view, however. Consider BarnesandNoble.com, which was caught in a three-year patent-infringement lawsuit filed by Amazon over the use of the 1-Click patent. Barnes & Noble was using a similar process, which it dubbed "Express Checkout," when Amazon won an injunction against the bookseller in 1999.

As a temporary fix, Barnes & Noble circumvented the Amazon patent by launching a 2-click process to buy merchandise. By 2002, however, the two Internet retailers settled the matter under undisclosed terms, and Barnes & Noble reportedly licensed the technology from Amazon. Both Amazon and Barnes & Noble declined to comment.

Companies that don't hold business-method patents will likely view a *State Street* reversal as a victory over poor-quality patents. But what happens to those that now hold business-method patents? According to John Cronin, managing director and chairman of ipCapital Group, patents are not invalidated by a reinterpretation of law, but rather by a legal challenge under current law. So, if *State Street* is overturned, patent holders will have tenuous recourse: launch new lawsuits and gamble that their arguments don't crumble under the weight of new precedent.

Congress could always step in, as it did in 1996 to ban the patenting of surgical and medical procedures. However, says Coggins, that law was applied prospectively, and as is usually the case with an overturned ruling, new lawsuits would be heard under the new law. Moreover, the current reform of patent laws being considered in Congress will do little to resolve the debate; the only proposal that specifically addresses business methods is one to eliminate tax-strategy patents (see "Here, Take My Tax Process" at the end of this article).

The possibility that business-method patents may be invalidated by an upcoming court decision does not worry all companies — even those built around crucial processes. Witness bioscience company Kensey Nash Corp., in Exton, Pennsylvania. Although the company holds patents for its endovascular technology and devices, it doesn't hold any for much of its biomaterials business, where it utilizes synthetic polymers, bovine collagen, and ceramics in the design, development, and manufacture of medical technology.

Processes and know-how, which are the backbone of the company's biomaterials business, don't fit the criteria for patentable subject matter, reasons Kensey Nash CFO Wendy DiCicco. If the *Bilski* case expands the universe of what is not patentable, she offers some advice: "In our industry, we cannot patent know-how or processes. Our tactic is to wrap up [know-how] in confidentiality and noncompete agreements," and label it a trade secret.

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Here, Take My Tax Process

Tax-strategy patents represent a special case in the debate over what constitutes a business process. Protected by the U.S. Patent and Trademark Office, such patents cover tax advice that is novel, nonobvious, and useful. They have caused a great deal of angst among tax professionals, and have raised the ire of the Internal Revenue Service.

Congress is also weighing in. In September, the House of Representatives passed the Patent Reform Act of 2007, a sweeping piece of legislation that includes a ban on tax-strategy patents. At press time, the Senate debate on patent reform reached an impasse, so it is unclear whether a compromise bill will eliminate tax-strategy patents for good.

The government's position, says Jeffrey Frishman, national managing principal, tax-practice policy and quality, for accounting firm Grant Thornton, is that tax-strategy patents "potentially undermine the government's focus on abusive tax practices." Tax-strategy patents promote incentives for "highly creative" tax planning, he adds.

Preparers have their own problems with them. While only 65 patents have been issued for tax strategies, auditors complain that they could inadvertently infringe on those patents because many of the protected processes are considered commonplace. In addition, says Grant Thornton's director of tax legislative affairs, Mel Schwarz, auditors and tax accountants are not trained in patent law, so determining if a tax strategy infringes on an inventor's rights is an onerous task.

More fundamentally, preparers have issues with patents tied to federal and state laws. "Ernst & Young has never sought patent protection for its tax-planning advice, because we do not believe that it is good public policy to allow such patents," remarks Mark Weinberger, vice chairman of E&Y Tax Services. "No one owns the tax law."

For its part, the IRS acknowledges that patented tax strategies place "an increasing burden on practitioners." However, in his testimony before the House Committee on Ways and Means in July 2006, IRS commissioner Mark Everson emphasized that the IRS's principal interest in the strategies "is in determining whether promoters are patenting abusive tax-avoidance transactions." At the same time, he warned, "a patent carries with it no assurance whatsoever that the patented process, transaction, or structure will pass IRS muster." — *M.L.*

Method Madness

A sampling of business-process patents held by companies in a range of industries

3M: Fast-food drive-through ordering process

Apple: iTunes reward system that gets kids to exercise

Target: Discount coupon card

Accenture: Tax scorecard

Microsoft: System for calculating bonus depreciation on assets

U.S. Post Office: Method for generating express mailing labels

JPMorgan Chase: Online directory of college loans and grants

System's Pride: Method for managing Lotto tickets and winnings bought by a group of co-workers

IBM: Online video depository for retail chain stores

American Express Travel: Online shopping cart

Huawei Technologies (China): Method of charging for telephone and Internet access

Fujitsu (Japan): Method for crowded restaurants to charge based on time spent at a table

Source: U.S. Patent and Trademark Office

URL: http://www.cfo.com/printable/article.cfm/11078594/c_11081639?f=options