

Current Developments in Business Method Patent Law

Michael P Sandonato, Jonathan Berschadsky, and Kristin Blemaster

Since the Court of Appeals for the Federal Circuit's decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*¹ in 1998, the US Patent and Trademark Office (USPTO) has been flooded with applications for patents on Internet and e-commerce inventions.² With the USPTO following what it considers a mandate from the Federal Circuit, many of these so-called "business method" patents have issued. Such patents, however, have been widely criticized as being directed to no more than applying known business practices to computers and networks, as being inappropriate attempts to "own the Internet," and as being simply too easy to get.³

In the authors' experience, the most commonly held opinion on this topic is that, although allowing business method patents is not a bad idea *per se*, the inexperience of the USPTO in examining applications in this field has resulted in many questionable business method patents. As a result, much of what we have seen in the last year and a half or so are efforts from various sources, including the legislature, the courts, the USPTO, and the patent bar, to improve the quality of business method patents that the USPTO issues and to afford those charged with infringement of such patents additional and improved defense mechanisms.

First Inventor Defense

One of the first reactions to the *State Street Bank* decision was the American Inventor's Protection Act of 1999 (AIPA), which enacted 35 U.S.C. § 273 (sometimes referred to as the first inventor defense). Under Section 273, it is a defense to a charge of infringement

Michael P Sandonato is a partner at Fitzpatrick, Cella, Harper & Scinto. Mr. Sandonato is active in all aspects of the firm's patent practice and co-chairs the firm's e-commerce and new media practice group. **Jonathan Berschadsky** is an associate at Fitzpatrick, Cella, Harper & Scinto, focusing on matters related to electronics, computer software, hardware, and e-commerce. **Kristin Blemaster** is a legal assistant at Fitzpatrick, Cella, Harper & Scinto. Ms. Blemaster is a senior at New York University, majoring in psychology and political science, and currently applying to law school.

of a patent on a "method of doing or conducting business" if the accused infringer in good faith actually reduced the method to practice at least one year before the filing date of the patent and used the method commercially in the United States any time before the filing date. "Commercial use" in this context means use of the method in connection with an internal commercial use or an actual arm's-length sale or transfer of a useful end result, whether or not the subject matter at issue was actually known or accessible to the public.

A little background here is helpful. Inventors of new and useful methods traditionally decide between two avenues of intellectual property protection: maintaining the method as a trade secret or filing a patent application. The idiosyncracies of the patent laws, however, historically create a pitfall in the trade secret route. Specifically, another party who subsequently and independently invented the same process could legitimately obtain a patent, bring suit, and enjoin the first inventor from practicing his own process because the first inventor's activities, due to their secrecy, may not qualify as prior art under 35 U.S.C. § 102. This phenomenon has motivated many companies to build extensive patent portfolios, not with an eye toward enforcing them, but to ensure free practice of their own technology. Enter the first inventor defense. Although not a vehicle for invalidating or taking the patent from the second inventor, this new defense provides what is in effect a royalty-free, nonexclusive license to continue practicing business as usual.

Though the need for the defense has existed for years, it has become acute in the wake of the *State Street Bank* decision and the ensuing flood of applications for business method patents. Recognizing that many business methods and processes were not patentable before *State Street Bank* and that it is administratively and economically infeasible for inventors to file applications on all of their methods and processes, Congress created the new defense.

Although the first inventor defense relates to methods of "doing or conducting business," it does not clearly define that phrase. To most, the term initially conjures up images of e-commerce, financial data processing, and other methods that were thought to be

unpatentable in the pre- *State Street Bank* era. But what about a method of making steel, if making steel is your business, and other methods that were routinely patented before the word “e-conomy” got its hyphen? Also, does the defense apply only to those claims that are drafted in method form *per se*, or does it apply to claims written in, for example, system or apparatus form? (The *State Street Bank* claims were not method claims *per se*; rather, they were directed to a data processing system.)

The AIPA’s legislative history indicates that the genesis of the first inventor defense was an effort to harmonize US patent laws with those of foreign countries, which typically require prior user rights. Although early harmonization efforts met with heavy opposition in Congress, the repercussions of *State Street Bank* were enough to push the defense to passage. The defense, as passed, is actually a compromise between competing versions from the two houses—an early House version that applied to any process that produces a useful end product or service and an early Senate version that was limited to methods of doing or conducting business. Although the final version of the defense is quite similar to the more restrictive Senate version, the accompanying legislative history suggests that the kinds of claims to which the defense applies are not so strictly limited. In particular, the history suggests that that term should be construed to mean any method that “contributes to the effectiveness of [a] business by producing a useful end result,” and that “the issue of whether an invention is a method is to be determined based upon its underlying nature and not on the technicality of the form of the claims.”⁴

Business Method Patent Initiative

USPTO efforts following *State Street Bank* have been largely directed toward improving its ability to examine business method applications, thereby improving the quality of issued business method patents. For example, on March 29, 2000, a few months after the AIPA became law, the USPTO announced its business methods patent initiative, which deals specifically with Class 705 patent applications.⁵ Class 705 is the classification devoted entirely to business methods and includes inventions relating to data processing, finance, business practices, management, and cost/price determination.

The initiative was designed to improve Class 705 patents by implementing industry outreach and quality programs. The industry outreach program was created to establish a formal customer partnership, to discuss mutual concerns, to share USPTO plans and operation efforts in the area of business methods, and to examine possible solutions to common problems. Furthermore, the industry outreach program strives to promote industry feedback on prior art resources used by the USPTO, solicit input on

other databases and information collections and sources, and expand prior art collections. As part of the program, the USPTO has committed to periodically convene forums with parties interested in business method patents in order to discuss issues of concern and possible solutions.

The main objectives of the outreach program are enhancing technical training, revising examination guidelines, and expanding current search activities to develop a more comprehensive review for prior art. For instance, it is now mandatory that examiners of Class 705 applications search issued patents, a WEST (text) electronic patent searching system, foreign patent documents, and non-patent literature (NPL) publications, as well as some World Wide Web resources. The Official Gazette notice will soon publish a listing of core NPL databases searched by the examiners and will ask for public comment. Web resources used in the search include Web-based dictionaries and glossaries such as eBilling.org’s *Glossary of Terms*,⁶ *Electronic Commerce Dictionary: New Terms Since 1995*,⁷ *Ecommerce Webopedia*,⁸ *Electronic Retailing Association Glossary of E-Terms*,⁹ and *History of the Internet*.¹⁰

In addition to these improvements, the business methods patent initiative introduced a second-level review of all allowed applications in Class 705. This “second look” measure ensures that the search requirements have been met and that the scope of the claims is appropriate. At the time of allowance, the reasons for allowance must meet three standards: (1) there must be at least one major difference from the prior art; (2) the claims must be compared to the closest prior art; and (3) the precise reasons for allowance must be given, without room for unwarranted interpretations. As of November 2000, 28 of the 460 applications subject to a second look have been ordered reopened.¹¹

Furthermore, two new positions have been created to oversee the examination of Class 705 applications: the Business Practice Specialist and the Senior Level Examiner. The responsibilities of the Business Practice Specialist include identifying and developing legal and procedural training needs related to the electronic commerce and data processing, acting as a resource on technical issues related to business method patents, and examining and providing input on applications involving complicated interference or business practice issues. The duties of the Senior Level Examiner are similar to those of the Business Practice Specialist, with the additional jobs of researching state-of-the-art information and briefing examiners on technology changes related to Class 705.

In addition, the examiners in Class 705 are being selected with greater care. Today, Class 705 has approximately 77 examiners, some of whom hold advanced degrees, such as PhDs, masters degrees, and MBA

degrees. In particular, the USPTO is making an effort to hire examiners with experience in financial analysis, marketing analysis, real estate analysis, business consulting, business development, business information systems, management, securities, insurance, banking, and sales.

Roundtable on Business Method Patents

As part of the USPTO initiative, the first Roundtable on Business Method Patents was held by the USPTO on July 27, 2000, to discuss issues surrounding business method patents and improvement of the USPTO's examination of business method patent applications. Panelists at the roundtable included officials from the USPTO and a cross-section of patent attorneys, academics, representatives of trade associations, consumer advocates, and patent holders. Topics debated ranged from the specific methods used to examine business method applications to the more basic issue of whether business methods should be patented at all.

Much of the discussion focused on the procedures used by the USPTO to examine business method patents. In particular, the roundtable focused on how to improve the search for prior art. Also discussed were the possible advantages and drawbacks of allowing business method patents; specifically, whether business method patents constitute appropriate protection for innovation or are in fact barriers to innovation. Suggestions ranged from putting in place a pre-grant opposition procedure, to promulgating a list of *per se* unpatentable business methods, to establishing a private attorney general system in which the USPTO provides bounties to members of the public who submit invalidating prior art. Although no conclusions were reached at the roundtable, many interesting, and in some cases controversial, ideas were exchanged.

The USPTO encourages the public to help guide the future of business method patent law. For those interested, the USPTO has requested suggestions and comments from the public and will use that information to set the agenda for the Fall 2001 Business Methods Partnership Meeting.¹²

Comments from the American Intellectual Property Law Association

On November 27, 2000, the American Intellectual Property Law Association (AIPLA)¹³ circulated a white paper,¹⁴ "Patenting Business Methods," in response to widespread criticism of patents on computer- and Internet-implemented business methods. In the white paper, the AIPLA takes the position that business method inventions should be protected under the same laws

under which other inventions are protected and that no special test or interpretation of the patent laws should be applied to business method inventions. It also states that US inventors of business method innovations should not be substantively or procedurally disadvantaged compared to their foreign competitors by changes in the US patent laws.

The white paper recognizes, however, that the USPTO needs to improve its skills at examining applications in this area. Specifically, the AIPLA recommends that the USPTO continue to hire more examiners with business backgrounds, such as MBAs, and that it continue to aggressively improve the skills and training of new examiners. It also recommends that the PTO collect non-patent business methods prior art, including those describing business methods not implemented on a computer.

Furthermore, the white paper suggests amending the current laws to provide for early re-examination with a third-party right to appeal to the Federal Circuit, with no estoppel attaching to USPTO decisions not reviewed by the Federal Circuit. In addition, the white paper proposes that the new laws regarding publication of US applications after 18 months be allowed to have their effect. It advocates a broad interpretation of the first inventor defense to encompass claims to methods of doing business regardless of the area of technology and regardless of the form of the claim. Finally, it recommends that Congress restore to the USPTO full use of fees collected from patent applicants and patentees.

Pending Legislation

Currently, there is a movement in Congress to significantly change the patent laws as they apply to business method patents. On April 3, 2001, Rep. Howard Berman (D-CA) and Rep. Rick Boucher (D-VA) introduced H.R. 1332, the Business Method Patent Improvement Act of 2001. This bill is a revision of a similar bill (H.R. 5364) introduced by Reps. Berman and Boucher last October at the end of the 106th Congress. The revised bill is designed to improve the USPTO's handling of patent applications for business method inventions. In particular, its aim is to stop the proliferation of patents that seek possession of tools that are fundamental to e-businesses.

The new bill proposes that the USPTO be required to publish all business method patent applications after 18 months and that the public be given the opportunity to present prior art or public use information before a business method patent issues. It further proposes that patent applicants be required to disclose their prior art searches to give examiners a road map to follow in their own searches, to assist examiners in obtaining a variety of sources or prior art references that they otherwise would

not have discovered. Of particular interest is the bill's aim to hold business method inventions to higher standards than other types of inventions by creating a new, more challenging definition of "obviousness" and by requiring a determination of the "significance" or whether the invention "is appropriate for use with a computer technology."

In terms of dealing with already secured patents, the bill proposes to establish a process whereby parties may challenge a granted business method patent through a more efficient, less costly alternative to litigation. The bill also lowers the burden of proof for invalidating a business method patent. That is, the challenger of the validity of a patent would need to show only a preponderance of evidence, rather than the current, more demanding standard of clear and convincing evidence.

The House Judiciary Subcommittee on Courts, the Internet, and Intellectual Property held an oversight hearing on business method patents on April 4, 2000.¹⁵ At that hearing, witnesses offered their views on whether business method patents should be treated differently from other types of patents. To begin the hearing, Rep. Berman stated that, although the USPTO's business method patent initiative is a step in the right direction for improving the quality of business method patents, it is insufficient by itself, and that further legislation will be necessary to improve the quality of these patents.¹⁶

Following Rep. Berman's statement, Nicholas Godici, the acting Undersecretary of Commerce for Intellectual Property and acting Director of the USPTO, argued against legislation restricting patentability of business method patents, noting that *State Street Bank* never created a business method exception, but rather clarified that a business method should be treated in the same manner as any other method or process invention.¹⁷ Though Godici conceded that concerns about whether business methods should be patentable and about whether business method patents will inhibit innovation and commerce by precluding competition in a new business are legitimate, he claimed that such concerns are being adequately addressed by the USPTO's business method patent initiative. In particular, he argued that the initiative has improved the situation by providing access to more databases, instituting a second-level review of allowed applications in Class 705, and providing better training.

Modifications to the rules, Godici added, will further improve the quality of business method patents. In particular, he discussed the new rule 37 C.F.R. § 1.105, which provides examiners the authority to ask applicants for information that may be reasonably necessary to properly examine an application or related matters. Godici also referenced Rule 37 C.F.R. § 1.99, which permits third

parties to submit published applications without attribution of how that art affects patentability.

Also at that hearing, Michael Kirk, the Executive Director of the AIPLA, made arguments for the positions set forth in the white paper that had been adopted by the AIPLA. He agreed with Rep. Berman and Mr. Godici that, generally, a patent should not issue on a known business process when the only contribution by the applicant is in implementing that process via a computer.¹⁸ However, he stressed that there is no basis for legislation, such as the Berman/Boucher bill that "discriminates" against business method patents, and that business method patent application should be examined for compliance with the requirements of existing 35 U.S.C. §§ 101, 102, 103, etc. Kirk further asserted that singling out such patents for patent law reform may be incompatible with US obligations under the Trade Related Aspects of Intellectual Property Rights (TRIPS) accord.¹⁹

Kirk agreed with Mr. Godici that enhancement of the collection of non-patent prior art, improvement in examiner training, hiring more examiners with business backgrounds, and adequate funding of the USPTO are all essential to assuring better quality patents. He also proposed, on behalf of the AIPLA, an optional *inter partes* post-grant opposition procedure for reviewing issued patents, with appeals to the Federal Circuit. Such a procedure, he stated, should be for all types of patents and not limited solely to business method patents.²⁰

Finally, Kirk noted that the AIPLA generally supports the USPTO initiative but that some of the new procedures implemented by the initiative, such as the "second look," may come at a cost of longer pendency of business method patent applications. Such a lengthened pendency, he added, may cause companies and inventors to maintain their inventions as trade secrets, rather than to have their applications published at 18 months without yet obtaining a first opinion on patentability from the USPTO.

Ronald Myrick, president of the Intellectual Property Owners Association, agreed with Mr. Kirk that Congress should not legislate in the area of business method patents.²¹ He noted that for the patent system to operate effectively, legal principles under which patents are examined by the USPTO must be clear and capable of application with a reasonable degree of certainty. Myrick's argument was that special legislation for business method patents will lead to endless litigation over whether inventions were inside or outside the law.

Everyone at the committee agreed that patent fees that had been diverted from the USPTO to the general Treasury should be restored. Everyone also agreed that hiring additional highly qualified examiners, providing more educational and training assistance for these

examiners, and improving database resources are all steps in the right direction.

Court Decisions

Court decisions in the business method patent area have been relatively few since *State Street Bank*, so it is difficult to see any trends. If any pattern has emerged, it is that courts will not challenge or otherwise narrow the patentability of business method patents as a general concept, but will hold the specific business method patents they review to a strict level of scrutiny with respect to the traditional requirements of novelty and nonobviousness.

For example, in *Amazon.com Inc. v. Barnesand Noble.com Inc.*,²² the US Court of Appeals for the Federal Circuit reversed a district court's preliminary injunction with respect to Amazon's now notorious one-click shopping patent,²³ holding that there are substantial questions with respect to the validity of the patent. The Federal Circuit's decision is perhaps as significant for what it is not as for what it is. It is not a wholesale indictment of the patentability of business method patents or a restriction in any way from the principles articulated in *State Street Bank*. It is a conventional comparison of the claims at issue with a specific piece of prior art, ending in a conclusion that the defendant mounted a challenge to the validity of the patent serious enough to undermine the prerequisites for a preliminary injunction.

The proceedings in *Netzero Inc. v. Juno Online SVCS Inc.*²⁴ tell a similar story. On December 26, 2000, NetZero filed a complaint against Juno alleging patent infringement on NetZero's patent directed to pop-up ads.²⁵ On January 5, 2001, the court issued a temporary restraining order against Juno, holding that NetZero had demonstrated a likelihood of success on the merits. That order expired on March 15, 2001. In April 2001, however, that same court denied NetZero's motion for a preliminary injunction. Without analysis, the court's order states that Juno had raised "serious questions about the validity" of NetZero's patent, citing the Federal Circuit's decision in *Amazon.com* as its only authority.²⁶

Notes

1. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).
2. See Oversight Hearing on Business Method Patents Before the Subcomm. on Courts, the Internet, and Intellectual Prop., House Comm. on the Judiciary, 107th Cong. (Apr. 4, 2001) [hereinafter *Hearing*] (statements of Nicholas P. Godici and the Honorable Howard L. Berman), at <http://www.house.gov> (last visited July 18, 2001). Applications for business method patents were 1,300 in 1999. In 2000, approximately 7,800 applications were filed, representing 2.6 percent of all applications filed in fiscal year 2000. In the first quarter of fiscal year 2001, such filings increased by 18 percent to 20 percent higher than in the first quarter of fiscal year 2000. See United States Patent and Trademark Office, *Class 705 Filing Data* (displaying the latest statistics on business method patent application filing and issued data), at http://www.uspto.gov/web/menu/pbmethod/application_filing.htm (last visited July 18, 2001).
3. See James Gleick, "Patently Absurd," *New York Times Magazine*, Mar. 12, 2000, available at <http://www.nytimes.com/library/magazine/home/20000312mag-patents.html> (last visited July 18, 2001). See also Philip E. Ross, "Patently Absurd," *Forbes.com*, May 29, 2000, at <http://www.forbes.com/global/2000/0529/0311090a.html> (last visited July 18, 2001).
4. H.R. Rep 106-464 (Nov. 9, 1999).
5. United States Patent and Trademark Office, Automated Financial or Management Data Processing Methods (Business Methods) (a white paper on business methods outlining the initiative), at <http://www.uspto.gov/web/menu/busmethp/index.html> (last visited July 18, 2001).
6. eBilling.org, Glossary of Terms, (last visited July 18, 2001).
7. Ted Haynes, *The Electronic Commerce Dictionary: The definitive terms for doing business on the Information Superhighway* (The Robleda Co. 1995).
8. Ecommerce Webopedia, at <https://www.webopedia.com/ecommerce/> (last visited July 18, 2001). Updated 10/08/2021
9. Electronic Retailing Association Glossary of E-Terms, at <http://www.retailing.org> (last visited July 18, 2001).
10. History of the Internet, at <http://www.loc.gov/global/internet/history.html> (last visited July 18, 2001).
11. See Wynn Coggins, Technology Center, "The Evolution of the Business Method Patent and Update on the Business Method Action Plan," *USPTO Today Online*, Vol. 1, No. 12 (Dec. 2000), available at <http://www.uspto.gov>
12. See www.uspto.gov/web/menu/pbmethod/ for more information as to when and where the meeting will be held.
13. The AIPLA is a national bar association with approximately 12,000 members. The members consist primarily of lawyers in private and corporate practice, in government service, and in the academic community involved directly or indirectly in intellectual property law. American Intellectual Property Law Association (last visited July 18, 2001).

14. American Intellectual Property Law Association, *AILPA White Paper*, at <http://www.aipla.org> (last visited July 18, 2001).
15. See Hearing, *supra* n.2. See also “Legislation /Business Method Patents PTO, IP Representatives See no Need for Legislative Curbs on Internet Patents,” *Patent Copyright & Trademark Journal*, Vol. 61 No. 1518 (Apr. 13, 2001), available at http://ipcenter.bna.com/ipcenter/1,1103,1_873,00.html.
16. Hearing, *supra* n.2 (statement of the Honorable Howard L. Berman).
17. *Id.* (statement of Nicholas P. Godici).
18. *Id.* (statement of Michael K. Kirk).
19. Article 27.1 of TRIPs provides that a “patent shall be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involved an inventive step and capable of industrial application . . . patents shall be available and patent rights enjoyable without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced.” Agreement on Trade Related Aspects of Intellectual Property, Art. 27.1 (1995).
20. Hearing, *supra* n.2 (statement of Michael K. Kirk) (the “AIPLA proposes instituting an early, truly inter partes opposition proceeding. The proposed proceeding would be in addition to those presently available under 35 U.S.C. §§ 301-307 (*ex-parte* re-examination) and §§ 301-307 (optional *inter partes* re-examination). It would require a third party to initiate an opposition proceeding within a very short time period after patent grant, for example, one year, and would permit the third party to challenge the patent on the basis of Sections 102, 103, and 112. The third party opposer would be permitted to participate before the USPTO in generally the same manner as a third party requester is now permitted to participate in optional inter partes reexamination, with one very important difference: the third party opposer would be permitted to appeal, and to participate in an appeal of, a decision of the Board to the Federal Circuit.”).
21. *Id.* (statement of Ronald E. Myrick) (“Recent developments demonstrate that the PTO and the courts are dealing with the issues.”).
22. See *Amazon.com Inc. v. BarnesandNoble.com Inc.*, 239 F.3d 1343 (Fed. Cir. 2001).
23. US Patent No. 5,960,411 (issued Sept. 28, 1999).
24. See *Netzero Inc. v. Juno Online SVCS Inc.*, No. D2:00cv13378 (C.D. Cal. filed Dec. 26, 2000).
25. US Patent No. 6,157,946 (issued Dec. 5, 2000).
26. See *Netzero Inc. v. Juno Online SVCS Inc.*, No. D2:00cv13378 (C.D. Cal. April 18, 2001)(order denying preliminary injunction).