

BUSINESS METHOD PATENTS IN THE UNITED STATES: A LEGISLATIVE RESPONSE

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The role of business methods in patent law has evolved tremendously over the past century. This article provides an in-depth analysis of one legislative response to recent court cases. More specifically, the “First Inventor Defense”³ will be discussed.

The basis for the determination of statutory subject matter can be found in 35 U.S.C., section 101, which states that:

“Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.”

While the foregoing statute provides the basic definition of statutory subject matter, it is very general. As a result, the details of the specific technologies that could be considered to fall within this category are open to interpretation by the courts and the U.S. Patent and Trademark Office (USPTO).

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³ 35 U.S.C. § 273.

I. An Overview of State Street Bank⁴

After years of court holdings in support of the business method exception doctrine that was established in the late 1800s and early 1900s, the Federal Circuit tackled the issue of business method patents head-on in *State Street Bank and Trust v. Signature Financial Group*.⁵

In *State Street*, the Court held that a mathematical algorithm embodying a machine performing a method of doing business and directed to a useful application of the mathematical algorithm is a statutory machine under 35 U.S.C. § 101.⁶ the relevant claimed invention was directed to a financial management system with a “hub and spoke” design. In contrast, the court distinguished unpatentable algorithms as those algorithms that are merely abstract ideas constituting disembodied concepts or truths, and lacking the required useful application.⁷

In stark contrast to the majority of previous cases discussing the patentability of business methods, *State Street* signaled the end of the business method exception doctrine.

II. The Legislative Response

In response to *State Street*,⁸ 35 U.S.C. § 273, also known as the “first inventor defense”, was enacted on November 29, 1999. According to its proponents, §273 created a much needed balance between the relatively new patentability of business methods under *State Street*, and the more traditional practice of maintaining such innovations as trade secrets. Traditionally, prior to *State Street*, businesses that utilized innovations in business processes maintained these

⁴ 148 F.3d 1368 (Fed. Cir. 1998).

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ 149 F.3d 1368 (Fed. Cir. 1998).

innovations as trade secrets, with the understanding that patent protection was not available. Often, such processes remained unpublished and generally unknown to the public for years or decades. Due to *State Street* and the resultant patentability of these processes, however, businesses, such as those mentioned above, which have practiced certain methods as trade secrets for years may now face charges of infringement of recently-obtained patents. Section 273 comes in on the side of such businesses, providing them with a new defense to infringement actions.

A. Background:

Section 273 is an affirmative defense requiring a defendant, facing charges of patent infringement and wishing to assert the defense, to bear the burden of proof under a standard of clear and convincing evidence.⁹ Accordingly, a defendant must prove:

- a) that the invention for which the defense is asserted is for a method of doing business;¹⁰
- b) that the defendant reduced the subject matter to practice prior to a year before the effective filing date of the patent;¹¹ and
- c) that the defendant began commercial use of the method in the United States before the effective filing date of the patent and has continued the commercial use without abandonment.¹²

⁹ “A person asserting the defense under this section shall have the burden of proof of establishing the defense by clear and convincing evidence.” 35 U.S.C. § 273(b)(4).

¹⁰ “It shall be a defense to an action for infringement under section 271 of this title with respect to any subject matter that would otherwise infringe one or more claims for a method in the patent being asserted against a person...” 35 U.S.C. § 273(b)(1). “[T]he term ‘method’ means a method of doing or conducting business.” 35 U.S.C. § 273(a)(3).

¹¹ 35 U.S.C. § 273(b)(1).

¹² *Id.*

B. Defining a Business Method

Arguably, the most important aspect of the §273 defense is that it can only be asserted against a charge of infringement of a business method patent. While there is no official definition of a “business method,” the USPTO has gone farther than legislative and judicial branches in categorizing business methods. According to USPTO practice, applications for patents are divided into technology classes in order to facilitate examination. The definition of the USPTO’s Class 705, to which business method patent applications, are generally directed, is:

“the generic class for apparatus and corresponding methods for performing data processing operations, in which there is a significant change in the data or for performing calculation operations wherein the apparatus or method is uniquely designed for or utilized in the practice, administration, or management of an enterprise, or in the processing of financial data. This class also provides for apparatus and corresponding methods for performing data processing or calculating operations in which a charge for goods or services is determined.”¹³

This definition is supplemented with guidelines defining the “scope of the class.” According to these guidelines, class 705 is “generally used for problems relating to administration of an organization, commodities or financial transactions.”¹⁴ This clearly encompasses the financial “hub and spoke” method of *State Street* fame. However, “[m]ere designation of an arrangement as a ‘business machine’ or a document as a ‘business form’ or a ‘business chart’ without any particular business function,” the guidelines provide, “will not cause classification in [class 705] or its subclasses.”¹⁵ The guidelines further provide that a “significantly claimed apparatus, “which would generally fall outside class 705, but which is

¹³ <http://www.uspto.gov/web/offices/ac/ido/oeip/taf/def/705.htm>, last visited on February 2, 2004.

¹⁴ *Id.*

¹⁵ *Id.*

claimed in a combination with class 705-appropriate material will be classified according to its separate class, whereas a “nominally claimed apparatus,” which would likewise generally fall outside class 705, when claimed in combination with class 705-appropriate material, will be included in class 705. It is unclear whether this means that the claims directed to the “nominally claimed apparatus” would also be considered to be business method claims for the purposes of §273. The guidance provided to date is described in greater detail below.

Unfortunately, the legislative and judicial branches have provided no clear definition of what constitutes a “business method.”

The Legislature. The only explanation that the legislature has provided is within the text of the § 273 statute itself, which fails to elaborate on this subject. The statute provides only that the method asserted in the patent must be “a method of doing or conducting business.”¹⁶

The Courts. With the inclusion of business methods as patentable subject matter under *State Street*, the courts now recognize vastly more patentable subject matter than was previously recognized. However, the courts have yet to define how business methods are distinguishable from non-business methods based on claim wording. For example, it is unclear how a patent, including one or more business method claims, in addition to non-method claims, as defined in the “scope of the class” for class 705, would be characterized by the courts.

Summary. Due to these varying interpretations given to business method patents by both the courts and the USPTO, therefore, counsel for a defendant of an infringement suit should take carefully consider whether the asserted patent could be classified as a business method patent.¹⁷

¹⁶ 35 U.S.C. § 273(b)(1) and 35 U.S.C. §(a)(3).

¹⁷ *See In re Rex D. Schrader and Eugene D. Klingaman*, 22 F.3d 290 (Fed. Cir. 1994). Here, the court attempted to define an algorithm, which is unpatentable and found that the definition of an algorithm
...(footnote continued)

C. Reduction to Practice

Proving reduction to practice by a defendant requires satisfying a two-prong test. First, the defendant must show that the accused process meets every element of the asserted patent. Second, the defendant must show that the accused process is operated for its intended purpose.¹⁸ Moreover, the defendant may be called upon to show that his knowledge of the subject matter was not derived from either the patentee or persons in privity with the patentee. If the defendant obtained knowledge of the patent through, for example, a former employee of the patentee or through reverse-engineering of the patentee's product, the defendant fails to meet all the requirements of a § 273 defense.¹⁹

D. Commercial Use

The reduction to practice requirement goes hand in hand with the requirement that the defendant must have begun commercial use of the method before the effective filing date of the patent and must have continued the commercial use without abandonment. The legislative history of § 273 defines commercial use as “use of a method in the United States, so long as such use is in connection with an internal commercial use or an actual arm's-length sale or other

was “not universally agreed,” and that “[o]ne working definition is that ‘an algorithm is an unambiguous specification of a conditional sequence of steps or operations for solving a class of problems’”. The court defined a process as “an act, or a series of acts, performed upon subject matter to be transformed and reduced to a different state or thing”. See also, *State Street Bank and Trust v. Signature Fin. Group*, 148 F.3d 1368 (Fed. Cir. 1998). Here, rather than attempt to define a business method patent, the court focused rather on the utility of the subject matter.

¹⁸ *Eaton v. Evans*, 53 U.S.P.Q.2d 1696 (Fed. Cir. 2000).

¹⁹ “A person may not assert the defense under this section if the subject matter on which the defense is based was derived from the patentee or persons in privity with the patentee.” 35 U.S.C. § 273(b)(3)(B).

arm's-length commercial transfer of a useful end result, whether or not the subject matter at issue is accessible to or otherwise known to the public.”²⁰

It should be noted that according to § 273, if commercial use was abandoned by the defendant at any time after the effective filing date of the patent, the defendant can not rely on that use.²¹ For example, if the effective filing date of the patent is January 1, 2000, and the defendant began commercial use of the method prior to January 1, 2000, the defendant may rely on that commercial use in establishing a subsequent § 273 defense. However, if the defendant began commercial use on May 1, 1999, abandoned commercial use on November 1, 1999, and did not resume commercial use until February 1, 2000, the defendant may not rely on the commercial use that occurred prior to November 1, 1999 in order to establish a § 273 defense.

E. Limitations on §273

The § 273 defense may appear to be an overly broad defense that would negate the value of any new business method patents. However, there are a number of limitations to the defense which should be taken into account. A successful § 273 defense does not invalidate the patent at issue, but rather acts as a shield, protecting the defendant from infringement liability.²² Further,

²⁰ 106 H.Rpt. 479 (1999) provides in part: (1) the terms 'commercially used' and 'commercial use' mean use of a method in the United States, so long as such use is in connection with an internal commercial use or an actual arm's-length sale or other arm's-length commercial transfer of a useful end result, whether or not the subject matter at issue is accessible to or otherwise known to the public, except that the subject matter for which commercial marketing or use is subject to a premarketing regulatory review period during which the safety or efficacy of the subject matter is established, including any period specified in section 156(g), shall be deemed 'commercially used' and in 'commercial use' during such regulatory review period.

²¹ “A person who has abandoned [the] commercial use of [the] subject matter may not rely on activities performed before the date of such abandonment in establishing a defense under this section with respect to actions taken after the date of such abandonment.” 35 U.S.C. § 273(b)(5).

²² 35 U.S.C. § 273(b)(9).

because § 273 is a *personal* defense, only the specific defendant who has met the requirements of the defense and who has successfully asserted it gains any right. Consequently, rights under § 273 are non-transferable.²³ Therefore, the defendant who successfully asserts a § 273 defense has not gained a general license of the patent, but only the right to personally continue practicing the method.²⁴

For example, if the asserted patent includes separate claims directed to a business method and to a software system, the defendant who successfully asserts a § 273 defense may continue to practice the business method, but does not have a general license for the software system covered by the patent.

F. Section 273 in the Courts

To date, a § 273 defense has only been asserted in one case of record: *Seal Flex v. W.R. Dougherty*.²⁵ However, the defendant in *Seal Flex*, W.R. Dougherty, asserted the § 273 defense only after summary judgment in the district court had been entered for the plaintiff. Therefore, the court found that the defense was untimely and did not rule on its merits.

²³ The defense under this section may be asserted only by the person who performed the acts necessary to establish the defense, and except for any transfer to the patent owner, the right to assert the defense shall not be licensed or assigned or transferred to another person except as an ancillary and subordinate part of a good faith transfer of the entire enterprise or line of business to which the defense relates." 35 U.S.C. § 273(b)(6).

²⁴ "The defense asserted by a person under this section is not a general license under all claims of the patent at issue, but extends only to the specific subject matter claimed in the patent with respect to which the person can assert a defense under this chapter, except that the defense shall also extend to variations in the quality or volume of use of the claimed subject matter, and to improvements in the claimed subject matter that do not infringe additional specifically claimed subject matter of the patent." 35 U.S.C. § 273(b)(3)(C).

²⁵ *Seal Flex, Inc. v. W.R. Dougherty and Assoc.*, 179 F.Supp.2d 735 (E. Dist. Michigan, 2002).

III. Strategies

A. Patentee/Plaintiff's Perspective Of 35 U.S.C. § 273

From the point of view of a patentee or a plaintiff in a patent infringement suit, the possibility of a defendant raising a § 273 defense should be taken into account as early as possible. Additionally, an applicant should take § 273 into account as early as possible and as often as necessary throughout the process of preparation and prosecution of the patent application, as discussed below.

Claim drafting. When drafting a patent directed to a business method, it is advisable to draft business method claims as well as parallel apparatus, system, and/or software claims. These parallel claims may prove beneficial, because as discussed, a § 273 defense may only be asserted against claims directed to business methods.²⁶ Thus, even if a defendant is successful in asserting a § 273 defense, the patentee who maintains parallel apparatus, system, or software claims may still assert those parallel claims against the defendant without fearing the invocation of a § 273 defense.

It is not uncommon, however, for a patent examiner to issue a restriction requirement when faced with a single application including both method and apparatus as well as system, or software claims.²⁷ In such a case, the applicant may file a divisional application including the apparatus, system, or software claims, which may be asserted without the possibility of a § 273 defense.²⁸

²⁶35 U.S.C. § 273.

²⁷ Generally, see MPEP 800, especially MPEP 803.

²⁸ 37 C.F.R. § 1.53; M.P.E.P. § 201.06.

Early filing. As with any application, it behooves the applicant to file as early as possible in order to antedate as much potential prior art as possible. With respect to a business method application, the applicant also benefits from early filing by avoiding a possible § 273 defense if the applicant anticipates that competitors may start practicing the claimed method in the near future.

Petition to Make Special. Due to the extra scrutiny accorded to business method patents by the USPTO²⁹ and the corresponding additional time required for completing examination of the application, if the applicant meets the requirements, it may be beneficial to file a Petition to Make Special³⁰ to speed up the prosecution process at a relatively low cost.³¹ However, if the applicant receives a restriction requirement, an application under a Petition to Make Special may be returned to the normal prosecution queue under certain circumstances.³²

Publication. An applicant who is filing only in the USPTO and not internationally must decide whether to have the application published at 18 months.³³ While the 18-month publication rule applies generally to patent applications and is not limited to business method patent applications, there are benefits and disadvantages to publication of the application that may be unique to business method patent applications. A benefit of publication is that when licensing the technology, down the road, the patentee may be able to receive back-royalties to the date of

²⁹ <http://www.uspto.gov/web/offices/com/sol/actionplan.html>, last visited on December 1, 2003.

³⁰ 37 C.F.R. § 1.102; *see also* M.P.E.P. § 708.02 for additional requirements of the Petition to Make Special.

³¹ 37 C.F.R. § 1.17(h).

³² Under M.P.E.P. § 708.02, *see* “SPECIAL EXAMINING PROCEDURE FOR CERTAIN NEW APPLICATIONS - ACCELERATED EXAMINATION”.

³³ 35 U.S.C. § 122(b).

publication. However, the drawback of publication of a business method patent is that it removes the method from the realm of trade secrets, by making it publicly known earlier than may be beneficial.

Minimizing the effect of a potential § 273 defense. Once a patentee has secured a business method patent, there are further steps that the patentee may take to minimize the negative effect of a § 273 defense. In order to avoid a potential § 273 defense, a plaintiff may attempt to negotiate a license with the defendant, rather than face the § 273 defense in court.

If faced with a successful § 273 defense, the plaintiff may still mitigate the effect of the defense. Most importantly, the plaintiff should monitor the defendant's use of the patented technology to ensure that there is no expansion of the use beyond the rights gained under § 273. The plaintiff should also ensure that the defendant is complying with the site limitations and nontransferability of the rights requirements under § 273.³⁴ With respect to site limitations, when the defense is acquired due to a transfer of business assets, the defense only applies to use at sites where the accused business method was being practiced by the defendant, at a time that is the later of the effective filing date of the patent application, or the date of the transfer of business assets.³⁵

B. Strategies, A Defendant's Perspective Of 35 U.S.C. § 273

From the point of view of a defendant facing a potential or actual charge of infringement of a business method patent, the defendant may consider the following options.

³⁴ 35 U.S.C. §§ 273(b)(7) and (b)(6).

³⁵ 35 U.S.C. § 273(b)(7).

A defendant in a position to assert a § 273 defense may also be able to invalidate the patent at issue by asserting its commercial activities as § 102(a) prior art.³⁶ However, the benefit of asserting a § 273 defense over invalidating the patent is that if the § 273 defense is successful, the defendant may continue to practice the method, as the first inventor, but its competitors other than the patentee and its licensees, successors, etc. may be precluded from practicing this method, because there is still a valid patent that may be asserted against them. However, the enforcement of the patent against infringing competitors would be up to the patentee.

However, if the defendant invalidates the patent, then the method may be freely practiced by the defendant and its competitors. If the defendant plans to transfer its rights as part of a good faith assignment or plans to transfer its entire line of business, the buyer may want to attempt to invalidate the patent under § 102(a) in order to avoid the site limitations of § 273(b)(7).

The defendant should consider the merits of the potential § 273 defense carefully, because a party that asserts the § 273 defense unsuccessfully may have to bear the attorneys' cost of litigation.³⁷

Finally, as preemptive measures, a company in a field where business methods likely to result in patents directed to business methods are widely used should internally document its activities involving business methods as early as possible, and should not abandon use of a

³⁶ “A person shall be entitled to a patent unless

(a) the invention was known or used by others in this country...” 35 U.S.C. § 102(a).

³⁷ If the defense under this section is pleaded by a person who subsequently fails to demonstrate a reasonable basis for asserting the defense, the court shall find the case exceptional for the purpose of awarding attorney fees under section 285 of this title. 35 U.S.C. § 273(b)(8).

business method if it may be used again in the future. This will facilitate the assertion of a § 273 defense in the future.

IV. Conclusion

The recognized scope of 35 U.S.C. § 101 has evolved to include business methods as patentable subject matter. As a result, various steps should be taken during the preparation, filing and prosecution of a patent application to maximize protection and minimize the possibility of a successful defense under 35 U.S.C. § 273.

Due to the rapidly growing and evolving nature of this area of patent law, there are numerous other topics worthy of further research and consideration. For example, other relevant issues include the role of business method patents in the international patent regime and intellectual property licensing issues.