

10 Years After State Street Decision That Transformed Patents, Appeals Court May Reverse Field

by *Steven J. Henry*

On July 23, 1998, a landmark federal court ruling affirmed patents for software-implemented inventions and methods of doing business. A few months later, another case applied this ruling to patents for apparatus as well. To some, this pair of decisions was disastrous. To others, they created bold new opportunities to secure financing and grow businesses. Ten years and thousands of software-related and business-method patent applications later, the United States Court of Appeals for the Federal Circuit is revisiting the issues and considering whether to take one or more steps backward, perhaps undoing its 1998 decisions in part or completely.

In *State Street Bank & Trust Co. vs. Signature Financial Group Inc.*, the Federal Circuit—the nation’s top patent court—ruled in favor of Signature, upholding its patent for a data processing system for mutual funds. The ruling opened the door to software-implemented and business-method patents—most for serious inventions, but a few for things that seem silly. Shortly thereafter, the court upheld Excel’s patent for a method of billing long-distance phone calls.

Now the Federal Circuit Court is considering whether the US Patent Office correctly rejected an application for a method of managing weather-related consumption risk in commodities trading, through hedging. The rejection in the *Bilski* case was premised on that method not being proper subject matter for a patent. The Patent Office denies that the prior *State Street* and *AT&T* rulings make the invention eligible for consideration and seeks a narrower reading of the law.

Where and how to draw the line between inventions eligible for patents and those that are not? It’s both a legal question and a policy question with economic implications.

In the current *Bilski* case the Federal Circuit elected to pull together all twelve judges to hear arguments and decide the case. This is important because only the full court sitting together—“en banc”—can overrule the panel decisions in the *State Street* and *AT&T* cases.

The judges asked for written comments from interested parties. Thirty-eight briefs were filed by bar associations, trade organizations, law professors and others. Oral arguments were held in early May 2008. A decision should be announced within the next few months.

In 1998, the court stated unequivocally that there was no legal justification for excluding business-methods from the patent system, and that it was bad policy for the courts to create exclusions where Congress had not. It said that if an invention produces a “useful, concrete, tangible result,” it should fall within the limits of the patent system.

Now, some expect the *Bilski* decision to drastically cut back on the availability of business-method patents. That seems unlikely, especially in light of the firm language of the 1998 decision. It’s more likely the Federal Circuit won’t toss out the *State Street* precedent entirely, but also won’t keep the status quo. The language from the *State Street* case leaves room for interpretation, so some clarification and tightening are likely.

It’s also a strong bet that the *Bilski* case will end up in the Supreme Court. The Supreme Court has already ruled that the patent statute defines eligible subject matter broadly, to include everything the Constitution permits Congress to make eligible. Yet the limiting term “useful arts” has never been construed by the Supreme Court, so the limits are in dispute. *Bilski*’s claim tests the limits.

That may not be the last stop. A good argument can be made that Congress, not

the courts, should make economic policy decisions, and that the “proper” reach of the patent system is such a policy decision. So far, however, Congress has largely stayed out of the debate.

Some argue that software should not be considered to be anything like a physical machine or chemical process. Advocates, on the other hand, point to the importance of software as a modern tool of technology, and the economic significance of new services, financial instruments and other business constructs.

Since 1998, investors have more enthusiastically funded early-stage software and e-commerce companies seeking patent protection for their innovations. Some fear the loss of protectability would diminish funding. They assert business-method patents foster innovation in an economy that increasingly depends on information and financial services. They say denying protection in software, financial services and other service areas might negatively impact development of e-commerce and financial services when the



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economy is in distress and feeling pressure from new competitors such as China and India.

Even advocates of patent protection, though, usually admit that there have been some egregious examples of unjustified software or business-methods patents. Nevertheless, they point out that it is questionable policy to frame the general rules so as

to prevent infrequent ‘lapses.’ This smacks of throwing the baby out with the bathwater. We may need the Patent Office to be more vigilant in applying the rules, but that does not mean we need to change the rules. Fine-tuning is appropriate; a sea change may have unintended consequences.