

## US Supreme Court Reiterates Two-Part Test for Patentability of Computer-Based Methods

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In a unanimous decision issued on June 19, 2014, the U.S. Supreme Court found that patent claims for managing risk in a financial transaction were drawn to an abstract idea that was patent-ineligible under 35 U.S.C. § 101. *Alice Corp. Pty. Ltd. v. CLS Bank Int'l et al.*, No. 13-298 (U.S. June 19, 2014). The opinion, authored by Justice Clarence Thomas, affirmed the *en banc* decision of the U.S. Court of Appeals for the Federal Circuit finding that the claims were invalid in a one-paragraph *per curiam* opinion. *CLS Bank Int'l v. Alice Corp. Pty.*, 717 F.3d 1269 (Fed. Cir. 2013) (*en banc*). In its decision, the U.S. Supreme Court reiterated a framework first set forth in *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 566 U.S. \_\_ (2012) for distinguishing patents that claim laws of nature, natural phenomena and abstract ideas from those that claim patent-eligible applications of those concepts. The decision will create renewed scrutiny for software and business method patents that are directed to patent-ineligible concepts.

### Procedural Background

CLS Bank International filed a declaratory judgment action against Alice Corporation Pty. Ltd. in the U.S. District Court for the District of Columbia on May 24, 2007, seeking a declaration of non-infringement, invalidity and unenforceability of U.S. Patent Nos. 5,970,470, 6,912,510, and 7,149,720. The claims at issue related to computerized methods for reducing risk in future events, such as financial transactions. The patents also recite computer-readable medium and system claims to achieve the same end. The methods are intended to reduce risk through the exchange of obligations between parties using data processing systems or data processing systems in conjunction with computer media reading code to direct the exchange of obligations. In other words, the methods are directed to computer programs that automatically track and manage obligations so that participants can minimize their risks.

The district court granted summary judgment of invalidity under 35 U.S.C. § 101 on the basis that both the system and method claims are not directed to patent-eligible subject matter because they claim an abstract idea and fail to satisfy the machine-or-transformation test. On appeal, a divided panel of the Federal Circuit initially overturned the district court's ruling. The Federal Circuit then granted rehearing *en banc* and vacated the panel decision, affirming the district court's decision in a one-paragraph *per curiam* opinion.

With the Federal Circuit's decision generating seven opinions from the 10-person panel, the *en banc* decision reflected significant discord within the Federal Circuit. Moreover, the decision generated no majority opinion that clarified the legal standard for determining patent eligibility under 35 U.S.C. § 101. On December 6, 2013, the Supreme Court granted *certiorari*. On March 31, 2014, oral arguments were held.

### The Supreme Court's Decision

In its unanimous decision, the U.S. Supreme Court affirmed the Federal Circuit's holding that the claims are invalid because they were directed to patent-ineligible subject matter.

In doing so, the Supreme Court reiterated its two-part test set forth in *Mayo Collaborative Servs. v. Prometheus Labs.* (Slip Op., at 7.) First, courts must determine whether

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the claims at issue are directed to a patent-ineligible concept. (Slip Op., at 7.) Second, courts must consider whether the elements of each claim — “both individually and as an ordered combination” — transform the nature of the claim into a patentable application. (Slip Op., at 7.) Put another way, courts must search for an “inventive concept” by identifying “an element or combination of elements” that is “sufficient to ensure that the patent in practice amounts to significantly more than a patent upon the [ineligible concept] itself.” (Slip Op., at 7.)

#### **A. Step One: Determine If Directed to an Abstract Idea**

In applying the first step of the test, the Court first determined that the claims were “drawn to the abstract idea of intermediated settlement.” The Court listed examples of abstract ideas that had been previously held patent-ineligible. (Slip Op., at 8 (citing *Benson*’s “algorithm for converting binary-coded decimal numerals into pure binary”; *Flook*’s “mathematical formula for computing ‘alarm limits’”; and *Bilski*’s “method for hedging against price fluctuations”).) However, the Court did not provide guidance regarding how to identify, characterize or articulate an abstract idea embodied in claims. The Court merely noted that the claims in *Bilski* were drawn to patent ineligible ideas because “hedging is a fundamental economic practice long prevalent in our system of commerce,” and the “concept of intermediated settlement” also is a “fundamental economic practice long prevalent in our system of commerce.” (Slip Op., at 8-9.) “Intermediated settlement,” the Court further found, “is also a building block of the modern economy” and thus, “like hedging, is an ‘abstract idea’ beyond the scope of § 101.” (Slip Op., at 9.)

The Court specifically rejected petitioner’s argument that “abstract ideas” are limited to “pre-existing, fundamental truth[s]” that “exis[t] in principle apart from any human action.” (Slip Op., at 10.) According to the Court, the *Bilski* patent was drawn to an unpatentable abstract idea, but the abstract idea was not a “pre-existing fundamental truth,” only a “longstanding commercial practice” and a “method of organizing human activity.” (Slip Op., at 10.)

#### **B. Step Two: Identify Elements Showing an Inventive Concept**

Turning to the second step of the test, the Court found that the method claims “fail to transform the abstract idea into a patent-eligible invention.” (Slip Op., at 10.) The Court clarified that “mere recitation of a generic computer cannot transform a patent-ineligible abstract idea into a patent-eligible invention.” (Slip Op., at 13.) Specifically, “[g]iven the ubiquity of computers ... wholly generic computer implementation is not generally the sort of ‘additional featur[e]’ that provides any ‘practical assurance that the process is more than a drafting effort designed to monopolize the [abstract idea] itself.’” (Slip Op., at 13.)

In finding the method claims unpatentable, the Court noted that the claims do not (1) purport to improve the functioning of the computer itself; or (2) effect an improvement in any other technology or technical field. (Slip Op., at 16.) The addition of “purely functional and generic” computer components also failed to save the system claims. (Slip Op., at 16 (“Nearly every computer will include a ‘communications controller’ and ‘data storage unit’ capable of performing the basic calculation, storage, and transmission functions required by the method claims.”).) Thus, the Court found that “[b]ecause petitioner’s system and media claims add nothing of substance to the underlying abstract idea, we hold that they too are patent ineligible under § 101.” (Slip Op., at 16.) In sum, all of the claims in the patent were held ineligible under § 101.

Three of the Justices joined in a concurring opinion that business method claims should not qualify as a ‘process’ under § 101. (Slip Op., Sotomayor, J., concurring.) However, that opinion did not garner a majority. Accordingly, the holding in *Bilski* that business methods are not categorically unpatentable remains unscathed.

## Implications for Patent Litigants

Although it remains to be seen how district courts, the Federal Circuit, and the U.S. Patent and Trademark Office will apply this decision, there likely will be renewed scrutiny for software and business method patents that are directed to patent-ineligible concepts:

- Litigants should reevaluate any pending actions involving claims that arguably may be directed to patent-ineligible concepts in light of the guidance provided by the U.S. Supreme Court in *CLS Bank*. In particular, inventions that could be characterized as long-standing commercial practices or methods of organizing human activity may face greater criticism.
- The Federal Circuit will now begin to apply the principles in *CLS Bank* in upcoming cases involving 35 U.S.C. § 101. Litigants should monitor those proceedings in order to determine how *CLS Bank* is being applied.
- The U.S. Supreme Court is currently considering whether to grant *certiorari* in three other cases involving patent eligibility under 35 U.S.C. § 101: *WildTangent, Inc. v. Ultramercial, LLC*, No. 13-255; *Bancorp Services, LLC v. Sun Life Assurance Co. of Canada (U.S.), et al.*, No. 13-584; and *Accenture Global Services, GmbH v. Guidewire Software, Inc.*, No. 13-918. All three cases are particularly relevant to those in the e-commerce field. Litigants should be aware that the U.S. Supreme Court may decide to revisit or further clarify *CLS Bank* by taking any of these cases in the next term.
- Challenges premised on 35 U.S.C. § 101 before the U.S. Patent and Trademark Office under the America Invents Act (AIA) will likely increase significantly in the coming months.

The Supreme Court's decision in *CLS Bank* confirms the standard for determining patentability of computer-based inventions under 35 U.S.C. § 101. Computer-based inventions account for an increasing proportion of new patents. There were approximately 125,000 software patents granted in 2011, up from 25,000 in 1991. Computer-based patents also dominate patent challenges at the U.S. Patent and Trademark Office — over 70 percent of challenges under the America Invents Act, for example, involve electrical and computer patents. As a result, the standard articulated in *CLS Bank* has the potential to significantly influence key technology sectors in the United States.

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