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## The Effects of State Street on Electronic Commerce and the Internet: The Year in Review

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It has been a little over a year since the Court of Appeals for the Federal Circuit explicitly held that methods of doing business (e.g., business models) are patentable. That decision, *State Street Bank and Trust Company v. Signature Financial Group, Inc.*, also effectively broadened the scope of potential subject matter that can be patented for software-related inventions, generally.

*State Street* involved a patent for allowing mutual funds to pool their assets into a central investment portfolio. Numerous articles have been written about this decision, predicting that it would have a profound impact on the financial, electronic commerce and software industries. This prediction was partly due to the concurrent development of new (and potentially patentable) electronic commerce and internet business models. Since a year has now past since the decision, the time has come to look back and examine what, in fact, the effects of *State Street* have actually been, and what those effects may mean for the future.

### **At the Patent Office . . .**

One almost immediate result of the *State Street* decision was that it brought certain patents relating to electronic commerce/business methods to the attention of the public. These patents, which have been frequently cited since *State Street*, include patent 5,715,314 owned by Open Market, Inc. relating to an electronic payment system for ordering merchandise, patent 5,794,210 owned by CyberGold relating to payment for viewing an on-line advertisement, and patent 5,794,207 owned by Walker Asset Management (known for Priceline) relating to a reverse auction. Although these three patents were allowed prior to *State Street*, *State Street* had the effect of affirming the validity of such patents and raising public awareness of their existence (and the potential for obtaining them). As a consequence, activity has visibly increased at the U.S. Patent and Trademark Office (PTO) in this area.

Indications of what has been occurring at the PTO in light of *State Street* are strongly

suggested from certain patent-related figures. For example, many of the types of patents mentioned above are classified by the PTO under "class 705," entitled "data processing: financial, business practice, management, or cost/price determination." Within this class, certain subclasses such as subclass 26 (entitled "electronic shopping (e.g., remote ordering)") have been particularly associated with the types of patents mentioned above, and are consequently more likely to be influenced by *State Street*.

Subclass 26 had 71 patents in it that had issued in 1998. So far in 1999 (at the time of this writing), there are 88. At this rate, there will be almost 130 patents in the subclass by the end of this year; 80% higher than last year. This is significantly greater than the recent trend for all utility patents issued by the PTO. Although the issued patents that referenced subclass 26 in 1999 were filed prior to the *State Street* decision, the nature of the technology in the subclass suggests that *State Street* likely played a role in the allowance process of those patents. In addition, these numbers (and other factors) indicate a likely continued upward trend in that subclass for the future.

Some patents to recently issue in subclass 26 are as follows:

U.S. patent 5,950,173, assigned to IPF, Inc., is directed to an internet-supported kiosk for use by consumers within a retail shopping environment, where a consumer can scan the universal product (bar) code of an item, and internet-based information relating to the scanned product will appear on a display screen. This allows a consumer to obtain additional information about an item to assist them in their ultimate purchase decision.

U.S. patent 5,926,796, assigned to Walker Asset Management, relates to allowing a person to subscribe to a magazine while at a retail outlet. The subscriber immediately receives the purchased magazine at the retail rate, while the retailer receives a percentage of each subscription sold. The invention of this patent thus facilitates on-line transactions for immediately obtaining a subscription to a magazine.

Patents in this field (and in this subclass) are not obtained only by smaller or newer companies. Companies such as Microsoft have also realized the potential in this area. For example, Microsoft Patent No. 5,897,622 relates to a merchandising system, and particularly to an architecture for allowing a merchant to adapt the system to its existing business practices.

In general, the trend toward obtaining patents in the areas commonly associated with electronic commerce and business methods has significantly increased, and signs indicate that the trend appears likely to continue into the future.

### **Litigation is stirring.**

Prior to *State Street*, many of the patents mentioned above would have arguably been of

questionable validity due to their subject matter. Not surprisingly, since *State Street*, the owners of these types of electronic commerce patents have been taking a more aggressive stance in asserting them against others. Two publicized examples are indicative of the increase and nature of activities transpiring in this area.

The first example involves two U.S. patents owned by Sightsound.com. These patents relate to transmitting a digital audio signal from the memory storage of a "first party" to the memory storage of a "second party," in conjunction with the electronic transfer of money to the first party. Sightsound.com has been pursuing licensing fees from various companies that offer music that can be downloaded through the Internet. In a letter said to have been sent to some of these companies, Sightsound.com asserted that its patents control "the sale of audio or video recordings in download fashion over the Internet." The patents in this situation, which were issued in 1993 and 1997, respectively, appear to have been first asserted at the beginning of this year, indicating a likely connection with the occurrence of the *State Street* decision.

The second example relates to the Priceline patent (5,794,207) mentioned above. Specifically, a company called MercExchange has alleged that its own patent relates to the same subject matter as that of Priceline. At the time of this writing, MercExchange is consequently attempting to provoke an "interference," which is a proceeding where the claims of a patent (or application) whose inventive concepts can be shown to have been "invented" first will survive, and the corresponding claims of the other patent (or application) will be cancelled.

In addition to MercExchange, Priceline now also has to concern itself with Microsoft, which recently introduced a service on its travel site that allows users to place bids on hotel rooms. Priceline is reportedly considering the issue of patent infringement with regard to its patents, but at the time of this writing has yet to file a lawsuit.

The Walker Asset Management patents mentioned above are far from the only ones owned by them, since they have recently become a veritable factory of e-commerce business models and patents. However, one possible factor that may contribute to preventing them from pursuing a claim against Microsoft is the large number of software and internet-related patents that Microsoft has scrambled to accumulate over the last few years. Having been badly burnt in the past by competitors (large and small) who owned key patents, Microsoft appears to have learned the value of obtaining patents and using them defensively.

From the current trends, it is likely to be only a matter of time before a significant amount of patent litigation appears in the courts relating to electronic commerce subject matter.

### **Pending Legislation**

Under current Patent Law, if a first party develops an invention but keeps it a secret, and a

second party independently and subsequently invents the same invention and obtains a patent on it, the second party would be able to sue the first party for patent infringement. Legislation that has been pending in the U.S. House of Representatives for some time has sought to, amongst other things, give that first user a defense to patent infringement, and thus the right to continue to use the invention. However, this "first inventor defense" portion of the legislation met with much resistance over the years.

Recently, in what appears to be a coup for the finance industry, agreement was reached whereby the first inventor defense would be limited only to situations where the patented subject matter relates to "a method of doing or conducting business." At the time of this writing, the legislation has recently been passed in the House and will now be taken up by the Senate.

While the proposed statutory changes contain a "definitions" portion, "method of doing or conducting business" is not among the terms defined. However, the Report accompanying the Bill does set forth some very general and non-exclusive definitional language. This language, though, will likely be only of limited help, and may actually add additional fodder for disagreement. The language does, however, strongly indicate the influence of the finance industry in carving out this portion of the Bill.

The influence of *State Street* on the "first inventor defense" portion of the legislation is clearly indicated in both the specific mention of that decision as well as in the rationale given for the defense's inclusion. Specifically, supporters of the legislation argue that, prior to *State Street*, it was believed that methods of doing business were not patentable, and thus many businesses had developed and used such methods in secrecy. Due to public manifestations of the "secret" use of many of those methods for more than one year, the methods are no longer available for patent protection under current patent laws. In addition, it was viewed as being unduly burdensome to expect that businesses should now attempt to obtain patents on all of those processes. Interestingly, however, that same argument could also have been made with regard to other new technologies, such as software, in years past.

## Conclusion

*State Street* has evidently begun to have a significant impact on various aspects of the patent system. As companies and individuals continue to obtain additional patents in the electronic commerce and business method arena for both offensive and defensive purposes, these effects will only increase. Stay tuned.

Scott Alter

[scott.alter@haledorr.com](mailto:scott.alter@haledorr.com)

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