

# INTELLECTUAL PROPERTY

## Contending with patents in financial services

The industry now faces increased litigation and threat of 'patent trolls.'

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BEFORE 1998, companies in the financial services industry enjoyed a relatively harmonious existence in a patent-scarce environment. That state of bliss has rapidly disintegrated as the number of patents, and hence patent enforcement actions, have risen in recent years. Wall Street powerhouses have had to scramble to assess and come to grips with intellectual property issues, including the need to build IP portfolios and profit from those IP investments, while at the same time contending with an increase in patent infringement litigation that may threaten their business.

Intellectual property is playing an increasing role in the development of business markets, leveraging of business opportunities and improving business efficiency. Financial services companies have filed patent applications on a wide range of product offerings from automated futures trading to insurance contracts to methods of risk management and underwriting. It is one of the fastest-growing segments of the patent process. IP poses substantial risks and opportunities for financial services companies as they confront changing business processes or adding new business methods to existing ones.

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common myth was that methods of doing business were not patentable, despite the fact that the patent statute provides that the inventor of "any new and useful process, machine, manufacture, or composition of matter...may obtain a patent therefore." 35 U.S.C. 101.

Indeed, as early as 1983, a claim to what was arguably a business method for a financial services company was determined to be patentable subject matter.

**PATENT**  
*Paine, Webber, Jackson & Curtis Inc. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 564 F. Supp. 1358 (D. Del. 1983). In that case, Merrill Lynch had obtained a patent on Cash Management Accounts, a financial product that combined the benefits of a securities account, a money market fund and a credit card with check-writing privileges. Id. at 1361-62.

Notwithstanding the broad language of the patent statute and the *Merrill Lynch* example, there continued to be a widespread belief among the industry and practitioners that there was a "business method" exception to the broad scope of patentable subject matter under § 101, and that such "methods of doing business" were not patentable. In *State Street Bank & Trust Co. v. Signature Financial Group Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), the U.S. Court of Appeals for the Federal Circuit laid "this ill-conceived exception to rest." Id.

*State Street* drew the attention that the industry missed when the *Merrill Lynch* case was decided. Combined with the new methods of delivering services that technology and the Internet provided, it created a perfect storm: From fiscal year 1998 to 1999, the number of business

method patent applications filed with the U.S. Patent and Trademark Office (PTO) doubled. See Class 705 Application Filing and Patents Issued Data, available at [www.uspto.gov/web/menu/pbmethod/applicationfiling.htm](http://www.uspto.gov/web/menu/pbmethod/applicationfiling.htm).

### Impact on the PTO

Of course, the rise in applications was accompanied by trials and tribulations, the most important of which was quality concerns about the ability of the PTO to properly review the applications and determine whether patents should issue. All patent applications are assigned a

### 'State Street' drew attention to business method patents.

classification number that reflects the type of technology of the invention. Business methods are generally assigned to Class 705. Class 705 was traditionally used to deal with inventions relating to computer processing and software, and most of the examiners were trained in computer or electrical engineering.

After *State Street*, those patent examiners were being asked to make determinations about "business methods" where they had little or no experience or expertise. One task of a patent examiner is to search the prior art to determine if an invention is novel and nonobvious. See 35 U.S.C. 102, 103. The search is traditionally performed on prior patents and publications. In the area of business methods, very little was available to the PTO in the way of written prior art.

The PTO worked to address these

problems by adding training and a second layer of review, adding patent examiners who had business training, and mandating additional review of nonpatent prior art. See USPTO White Paper, *Automated Financial or Management Data Processing Methods (Business Methods)*, available at [www.uspto.gov/web/menu/busmethp/quality.htm](http://www.uspto.gov/web/menu/busmethp/quality.htm). These steps have led to longer waits for patents to issue and, perhaps, a lower rate of patent granting than in other art areas.

In any event, in the years since the *State Street Bank* case was decided, a significant number of patents have issued and an even more significant number are pending. The PTO reports that in calendar year 1983, 34 patents were issued in Class 705. That number had risen to 727 in 2000, but tapered off to 423 in 2003. USPTO, *Patent Counts by Class by Year, January 1997-December 2003* (March 2004), available at [www.uspto.gov/web/offices/ac/ido/oeip/taf/cbcby.htm](http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cbcby.htm). From 1996 to 2002, more than 140 business method patents were issued in insurance, compared with 18 in the preceding four years, and from 2001 to the end of 2002 alone, more than 160 insurance patents were applied for. "Patents Pending," *Bests Review*, June 2004.

Patents have been and are being issued that affect all phases of financial services, from products, such as the Merrill Lynch Cash Management Account, to "back office" operations, such as managing an investment fund. See U.S. Patent No. 5,812,987 (issued Sept. 22, 1998).

Not surprisingly, some of these patents have led to litigation. For example, DataTreasury Corp., a provider of information-management systems, has filed at least six cases against banks and service providers on patents that deal with electronic clearing and archiving of checks. See e.g., *DataTreasury Corp. v. Ingincio S.A.*, No. 5:02CV95 (E.D. Texas filed May 2, 2002). The eSpeed Inc. affiliate of Cantor Fitzgerald L.P. sued several exchanges over its patent dealing with the electronic trading of futures, and it obtained settlements as high as \$15 million. "eSpeed Settles Wagner

Patent Claims," *Business Wire*, Aug. 27, 2002. eSpeed itself was sued last year on patents that deal with what is described as "Click Based Trading With Intuitive Grid Display of Market Depth." *Trading Technologies Int'l Inc. v. eSpeed Inc.*, No. 04 C 5312 (N.D. Ill. filed Aug. 12, 2004).

### Risks of litigation

The change in the intellectual property climate for financial services companies is happening rapidly and can have serious consequences for the unprepared. Litigation is increasing. During the past year, suits have been filed on patents against participants in the financial services industry on almost a weekly basis. Patent litigation is very expensive. Attorney fees and expert expenses can easily exceed \$1.5 million in a patent dispute in which the litigation exposure is valued at \$1 million to \$5 million. See American Intellectual Property Law Association, *Economic Survey 2003*, [www.aipla.org](http://www.aipla.org).

Patent disputes can have a devastating impact on a company's operations. Losing a patent infringement case usually leads to a permanent injunction against the infringing activity and the payment of at least a reasonable royalty to the patent owner. 35 U.S.C. 283-84. If a court finds that the infringement was "willful," treble damages can be awarded and attorney fees are available in exceptional cases. *Id.* at 284-85. Willfulness is determined based on "whether a prudent person would have sound reason to believe that the patent was not infringed or was invalid or unenforceable." *Knorr-Bremse Systeme Für Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337, 1347 (Fed. Cir. 2004), citing *SRI Int'l Inc. v. Advanced Tech. Labs. Inc.*, 127 F.3d 1462, 1465 (Fed. Cir. 1997).

To deal with this new environment, financial services companies need to be prepared both offensively and defensively. Operating in an IP-intense environment requires a different mindset. Every new approach to a problem can potentially be "property" owned by the company. To protect that property, the organization and its employees need to think in terms of

innovation and invention.

The company should organize and institutionalize the reporting of innovation. Reporting permits the company to consider the value of the intellectual property and what steps should be taken to protect and exploit it. Documenting the creation of new methods also permits a company to preserve priority in its inventions. (U.S. patent law protects the first to invent rather than the first to file. See 35 U.S.C. 102(g)(2)).

The inventive mindset is fostered when the company has a clear invention-submission process to permit employees to report their inventions. Likewise, once an invention disclosure has been made to the company, there should be a well-established protocol for reviewing the

## Companies must be prepared offensively and defensively.

invention and deciding how, or if, to protect it. Financial incentives are also useful to encourage employees to innovate and report those innovations. Taking these steps will help to foster an attitude of innovation and invention that provides a competitive advantage and legal protection.

### Patent or trade secret?

Having identified a new and valuable business method, a company must decide how to protect the invention. Generally, the choice will be between pursuing a patent or maintaining the method as a trade secret.

In order to obtain a patent, the company will have to describe the method in a way that both teaches others in the field how to practice the method and discloses the best method known to the inventors for practicing the method. 35 U.S.C. 112. A patent is valid for only a limited time. 35 U.S.C. 154.

Trade secrets, on the other hand, can be protected as long as the company takes reasonable steps to maintain the secret. Although subject to variances in state law,

a trade secret will generally extend to any business method one uses that provides “an opportunity to obtain an advantage over competitors who do not know or use” the method. *Ashland Mgt. Inc. v. Janien*, 624 N.E.2d 1007, 1013 (N.Y. 1993). The court will consider the steps taken by the company to keep the information confidential. *Id.*

The decision as to whether to keep a trade secret or seek a patent will often be reduced to practical considerations. For example, a product, such as the Merrill Lynch Cash Management Account, was not a good candidate for trade secret protection because competitors could see the product and easily copy the method.

In contrast, “back office” and internal methods, such as portfolio management, may be better preserved as trade secrets. Trade secret protection is ideal if only a small number of persons will need to know the trade secret and it is difficult for outsiders to identify it. One key consideration in choosing trade secret protection is that it can be difficult for a patent owner to enforce a patent if the infringing activity takes place out of public view.

### **Benefits of patent portfolios**

There are many benefits, defensively and offensively, to building a strong patent portfolio. Offensively, patents can be used to exclude or limit competition under the limited monopoly granted a patent holder. Patents can also be licensed to obtain royalty income. This is a particularly valuable opportunity when the method would be useful to those in related businesses or those with similar needs with whom the company does not compete.

A patent portfolio is also a useful defensive tool. The patent portfolio can deter competitors from suing on their own patents because of the risk of counterclaims. Also, cross-licensing of patent portfolios can be a beneficial way to settle litigation between competitors.

Another defensive tool is to have personnel who are familiar with business and patent law watch what competitors are doing. A new product or method could be a prelude to a patent that issues years

later. A company should be watching for patent applications that are assigned, published and issued to its competitors.

Even without developing a patent portfolio, companies are well advised to review their supplier agreements, employee agreements and other standard operations to ensure that they have adequate protection.

For example, even when purchasing software and equipment, the company should be careful to require appropriate indemnity provisions.

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## **Choice is between seeking patent or keeping trade secret.**

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The revolution in patenting in the financial services sector and the relatively unsullied terrain, have placed financial services companies at risk for the first time to a type of claimant well known in other sectors. Often referred to as “patent trolls” by attorneys and companies that litigate against them, these companies search out and buy patents, often from bankrupt firms, and then seek to enforce the patents against a large number of members of the industry. The most “valuable” patents for these purposes are patents with vague claims that can be read expansively.

The merits are rarely an issue with these patents. The goal is to get a license fee from as many companies as possible without ever having to actually litigate the meaning of the claims or the validity of the patents. The business strategy is to seek revenues by licensing the patent portfolio based upon favorable “financial terms” and, when necessary, to extract such terms by filing litigation to enforce the rights granted by the patents that have been purchased.

### **Dealing with patent trolls**

The patent trolls’ calling card has become very familiar. Often, the initial contact comes from an entity that does not participate in the industry and contains a full packet of information purporting to interpret the patent and analyze

how the industry’s products or methods generally fit within the claims. Almost always, the initial contact will include an offer for a license, demanding a price that is high enough to enrich the claimant, but low enough to discourage the target from mounting a litigation defense.

The best approach to these cases is to recognize that it is likely that many companies are being targeted. Identifying other targets of the campaign, banding together and presenting a united front can make fighting the claim cost-effective and deter the approach. Early retention of litigation counsel with substantial patent experience can help to position the company for success. Careful analysis of the patent and the claim history will help to evaluate the actual risk that a court would find infringement. Identifying prior art is often invaluable because the claimant adopts such a broad construction of the patent claims that it becomes fairly easy to find invalidating prior art.

Financial services companies are tempting targets. They tend to have money and a high volume of transactions. Even a low royalty rate can quickly add up. The barbarians are standing at the gate and have already rattled many financial giants in the industry. Patents in the financial services industry have had, and will continue to have, a profound impact and can be expected to stimulate innovation. Companies in the financial services industry long operated without any need to be concerned about the effect of patents on their operations. Today, those companies can no longer afford the bliss of ignorance. Many in the financial services industry still have not grasped the concept that patents are here to stay. Those that are in the wait-and-see-what-happens mode will be victims. Planning and foresight can help a company survive and profit in this environment.

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