

**PRESENTATION:**

**BUSINESS METHOD PATENTS**

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When we talk about a business method patent, we're really talking about a method or a system for engaging in transactions, or engaging in a variety of activities related to doing business. Are you advertising on the net? Are you making on-line purchases on the net, and so on?

There is a wide range of business method patents. They range from very complicated algorithms involving a lot of software implementation, to very simple and sometimes even trivial things. They range from patents pertaining to banner advertising – coupons and banners placed on web sites – to how to train a janitor to dust and clean. Other of these patents include online prescription drug sales, online banking, and email paging.

There is a lot of activity in this area. Last year there were a couple thousand of these applications filed; approximately 900 patents were issued to class 705, the class of business method patents and internet patents. Two common and representative examples are: (1) Amazon.com's "one click" ordering system (U.S. Patent No. 5,960,411), which is the subject of the litigation with Barnesandnoble.com in the *Amazon.com*<sup>1</sup> case; and (2) Priceline.com's reverse auction patent (U.S. Patent No. 5,794,207). Amazon.com's "one click" ordering system is novel and non-obvious. No one before taught how to go to a website, select those items you want, display information about those items, and then make it easy for you, the consumer. You do not have to go back and re-enter all this information; instead, the system uses web cookie technology, which has been around (and was the subject of another patent to Lou Montilly of Netscape). Information that is stored in a file is combined with information on the items that are ordered. Once the system receives the final "one click" from the consumer, the order is generated and all the shipping information is processed. This had never been done before by anyone in that way. On the other hand, the other side asks, "what do you mean by one click?" For example, you order one item and then if you do not want it, you go back, look at that item, and get some more information about that item. You can generate a whole bunch of clicks in order to get information. So, it is not really one click. It is only one click at the end. So what exactly does all this mean?

The other example is Priceline.com's reverse auction patent. The method here is truly quite different from the way a normal auction proceeds. Buyers set the price and sellers

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<sup>1</sup> *Amazon.com, Inc. v. Barnesandnoble.com, Inc.*, 73 F. Supp. 2d 1228 (W.D. Wash. 1999), *vacated and remanded by*, 239 F.3d 1343 (Fed. Cir. 2001).

decide whether to accept a specific bid. There are debates about whether there have been previous reverse auctions in the Netherlands. Nevertheless, the question remains whether it is non-obvious to take that information and implement it into software in an internet environment.

In the United States business method patents are here to stay for the near to intermediate future.

Now, where are we in this dot-com world? The simple reality is that the money squeeze is on. Many companies have sold their assets for pennies on the dollar. But it is really not as grim as the popular media would make it out to be. It is true that a lot of founders are putting their suits on and heading back to the corporate world that they fled from. On the other hand, statistics show that in the first quarter of 2000 internet companies managed to raise about \$8.5 billion, and in the first quarter of 2001 they have raised about \$2.2 billion. You might say that a 74% decrease in the amount of money made by these people is terrible. Well, yes it is terrible; but then many are still around, and \$2.2 billion is quite a lot of money. The bottom line is that lawyers are back to taking cash.

Why are these companies so interested in acquiring business method patents? One obvious reason is to join the current craze. We don't want to get sued by somebody else and not have our own stockpile of patents. We want our own "nuclear stockpile," so if we get sued, we have something to trade or to negotiate with.

If a company does have something new, business method patents provide a competitive advantage. For example, if you are a banner ad company like Coolsavings.com, you have figured out how to do advertising and marketing on the net. Coolsavings.com has acquired a bunch of patents and managed to prevent others from entering the market. Now, they have about 75% of the banner ad market on the net. They have done pretty well.

Now consider Amazon.com's "one click" patent. Amazon.com has successfully managed to license that technology to Apple Computer and others. Additionally, they have managed to get a preliminary injunction at the District Court level, from Judge Peckman right here in the Western District of Washington. Although strictly online, Amazon.com has still managed to gain a real competitive advantage through their patent, even when competing against a large entity like Barnes and Noble.

Another common reason why many companies use business method patents is to get licensing revenues; that is, if they can withstand scrutiny and due diligence. One common mistake people make is failing to license their patents because they are players in the field. You can be a player in the field and still license your patents. For example, a company that processes documents, essentially electronic processing of checks, has a very broad patent that covers electronic processing of credit card slips, checks, and so on. Most of their business revolves around processing checks for banks and having all that information displayed so that they can essentially engage in online financial transactions. There are other companies that are interested in doing the same thing for credit card slips. So in addition to using their technology within the check processing field, they should carve out the credit processing portion and license it to someone else.

In order to successfully license a patent, it has to survive due diligence. Due diligence involves a prior art search. Prior art searches of software patents are problematic because the terminology is not standard. For example, there may be two patents on the same thing

but there is no way to verify this because they use different terms to describe the exact same thing. Further, there is a lot of information in software handbooks that is not part of the patented regime. Additionally, in software patents you really have a very low policing of enablement. As a result, there is not a lot of information that is found in the software patent – especially if you go back and look at older patents. So that's definitely an issue.

Validity is always a concern for those who wish to invest in companies. You really do want to check it out. Keep in mind that often the value to a company is not just in the patent; it is in the whole package. A company may have some certain know-how and trade secrets that go along with it; it is sometimes hard to separate these out.

One important point that is often ignored is that business method patents are very helpful in creating assets for downside risk protection. During bankruptcy, bad things do happen and you have to be prepared for it. If you were to move into Chapter 11, for example, to buy some time from your creditors you may be able to reconstitute the company by using your patents to attract a new investor, who may be willing to take what you have and run with it. As a practical matter, business method patents are sometimes more valuable than contracts. Contracts may also survive, but often the company has gone down because the contracts were really not that good. So if you look at all the assets that a company might have at the time of bankruptcy, patents are often very valuable assets.

The *Amazon.com* opinion is very instructive and interesting. Much attention is paid to exactly how the claim was written. A lot of non-patent prior art in that case caused the Federal Circuit to believe that the validity of the patent would be challenged, which is why they reversed the preliminary injunction and sent the case back to the district court.

What I expect to see in the litigations related to business methods patents is much closer examination of the obviousness issue. The last I checked, the case was set to go to trial here in Seattle on September 10 [2001], so this is something for you to watch out for.

Another significant issue with a lot of these companies is what is called "down round" problems. A down round takes place when company stock is sold at a lower value than the valuation placed on the company by earlier investors. This causes dilution of ownership and stock options often become worth nothing. For example, say you have a private placement. You sold stock in your company for \$5.00 a share and you have sold five or ten percent of your company and raised a lot of money. But 18 months later no one is willing to buy your stock privately for \$5.00 a share. You would like to go public but now people are simply not willing to pay \$5.00. They think your valuations were wildly exaggerated and now they are only willing to pay \$1.00. You are running out of money and you want to keep your operations going. What do you do? Selling the stock for \$1.00 raises a lot of problems and many companies are currently dealing with such problems. Selling for \$1.00 wipes out all the stock options that were due to be exercised at prices far in excess of what the value is right now. As a result, there are many very unhappy employees and shareholders and a divestiture of ownership. There is considerable legal exposure for directors and officers who approved such down-round financing, unless proper precautions are taken, such as obtaining majority stockholder approval.

That is a quick overview of what is happening in this area. Thank you.