PRESENTATION:

BUSINESS METHOD PATENTS AND EMERGING TECHNOLOGY COMPANIES

Jeffrey Shelby*

I will discuss the business side of business method patents, especially in relation to emerging growth companies in the information technology field. From a capital-raising perspective, an emerging growth technology company's success will depend on a variety of factors.

One factor is the management team – especially whether the company has skilled, knowledgeable and experienced individuals performing key functions such as research and development, sales and finance. What are these individuals' reputations and backgrounds? If the company is missing any of these folks, what will be the cost to obtain them?

A second factor for a young company is going to be the market that it is in, or that it hopes to get in. Is that market emerging or developed? What is the potential size? And what portion of that market will this company eventually own?

A third factor is the company's overall risk profile. Matters to be considered include the stage of the company – is it young? Is their product about to be released? A lot of investors, principally venture capitalists, just will not consider investing in a company in a very early stage or in a very late stage, at least in the corporate finance field.

Part of the overall risk profile of a company is going to be the state of the financial markets, which went up funding marginal companies and are down. As we are seeing now, the capital even for good companies has dried up. It is not surprising that with the NASDAQ at about 50% of where it was last year, venture capital investing in the state of Washington has dropped 70% in a quarter-to-quarter comparison. Other factors important to capital raising include the company's competition and any barriers to market entry that may exist.

At some point in the capital raising cycle, a great deal of due diligence will be spent on assuring that the company actually owns or has licensed its intellectual property. Much inquiry will be made into the company and into its licensing and intellectual transfer agreements. Principle among these inquiries, at least for the earlier-stage companies, will be making sure that the founder has actually transferred his intellectual property. Additionally, the founder's status prior to joining the company must be examined to determine whether his old employer actually has rights to the IP.

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* Cooley Godward LLP.

Another important matter investors will want to know is whether all employees are parties to confidentiality agreements and intellectual property assignment agreements. Additionally, they will want to know the state of contractor and consultant non-disclosure agreements.

Investors will be interested in how the company is protecting its technology. The right approach in this area includes some combination of patents, trademarks, copyrights, and trade secrets. The right approach will also depend in large part on the company's technology, its goals, its budget, and its competition.

During the capital raising process, a company should expect to have its intellectual property protection measures questioned and second-guessed by investors. This might possibly include a complete review of all its intellectual property, and the hiring of an outside law firm to do a complete due diligence review. This would be a bottom-up approach and might include a complete review of the patents, patent applications, the search of prior art, and so on.

For most companies, the business method patent was sort of an afterthought. Only recently, in 1998, it rose to some prominence with the *State Street Bank*[1] decision that validated the business method claim, even though it has been around for a lot longer. In fact, I would expect that the most famous business method patent is the one by Herman Hollerworth that was patented in 1889, which was actually the precursor to the IBM punch card. These days we are looking at Amazon's one-click system[2] and Priceline's reverse auction.[3] British Telecom says they have patent on hyperlinking.[4] Sitesound.com believes they have the patent on delivering movies over the internet. E-data has a purported patent on all commercial electronic transactions that involve the transfer of digital information, in other words, the internet.[5]

You have made the big leagues when you make the cover of *The Economist* and *Newsweek*. This has happened with business method patents in the last year or two. Given their high profile in the popular press, emerging companies were quick to jump on the bandwagon, and quickly pointed out in their fund-raising efforts that they either had a business method patent or patent application in process, and that it was going to create immense value for their company. Investors, as well, were also quick to invest hundreds of millions of dollars in these companies and to encourage them to obtain business method patents. All of this, and in conjunction with the *State Street* decision, increased business patent applications from 1,300 to close to 8,000 from 1998 to 2000.

Why did folks believe that these business method patents were highly valuable assets? Well, for one reason, a lot of these companies were in the internet field. They believed that the internet had a low barrier to entry and if they could obtain a business method patent, that would raise the barrier to entry. In addition, everybody else was doing it, so you would

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[1] *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (1999).

[2] U.S. Pat No. 5,960,411.

[3] U.S. Pat No. 5,797,127.

[4] U.S. Pat No. 4,837,662.

[5] U.S. Pat No. 4,528,643.

need a nuclear arsenal to defend yourself. Further, they could also be used as cross-licensing opportunities.

What a difference a year makes. The bloom is now off the business method patent rose, so to speak. Recent developments have called into question the value of the business method patent, particularly in connection with internet, e-commerce, and software companies. First, in March 2000, the Patent and Trademark office announced its Business Method Patents initiative, which increased the number of examiners, their training, and recoup-mandated prior art searches, and also instituted a second level of review for all business method patents. Next the Federal Circuit came out with the *Amazon* decision, which brings into question prior art and the obviousness standard.

Additionally, Congress has been active. In 1999, it enacted the American Inventors Protection Act.[6] The Act provides a number of protections, including the First Inventor Defense, which provides an infringement defense if you have been using an invention in good faith for a year and a patent is later filed. The Act also provides for publication of patents applications eighteen months after filing if they are to be the subject of foreign filings as well. Also, Representatives Burman and Boucher introduced a bill last year entitled the Business Method Improvement Act of 2000. Congressman Burman has re-introduced the bill this year.[7]

Together, the recent failures of the dot-com companies, the *Amazon* decision, the PTO activities, and legislative activities have ended or at least quieted the debate on business method patents. Investors and others have realized that these patents can be patented-around like other patents. Additionally, they now realize that these patents do not provide the level of protection and the barriers to entry they once previously envisioned. They have become less powerful and less valuable methods of protecting one's intellectual property. Things have returned to normalcy.

Given the higher standards for business method patents, the overall lower valuations on emerging technology companies and the relative scarcity of capital, it is probably appropriate for companies and their investors to reconsider their focus on building business method patent portfolios. They should be considering the underlying fundamentals of protecting intellectual properties. Is the effort worth the protection? Will patenting this method provide value to the company? Will it result in greater financial success? Regardless of how a company answers these questions, they should remain vigilant in protecting their intellectual property; after all, a technology company's greatest asset is its technology.

Thank you.

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[6] Public L. No. 106-113, 113 Stat. 1537-544 (1999).

[7] HR 1332.