

The House Committee on the Judiciary
Subcommittee on Intellectual Property, Competition, and the Internet
March 30, 2011

Statement of The Honorable Steve Bartlett
for The Financial Services Roundtable

Hearing on the "America Invents Act"

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I am pleased to submit these comments, on behalf of Financial Services Roundtable.

The Financial Services Roundtable (www.fsround.org) represents 100 of the largest diversified financial services companies providing banking, insurance, and investment products and services to American businesses and consumers. While I am here to speak on behalf of the Roundtable, it is worth noting up front that we have worked closely with the American Bankers Association, the Clearing House Association, the Credit Union National Association, the Independent Community Bankers Association, the National Association of Federal Credit Unions, and the Securities Industry and Financial Markets Association, and others to address the problem of non-practicing entities, or NPEs that exploit flaws in the current patent system.

These NPEs have built an industry based on filing onerous lawsuits involving low-quality business method patents with the expectation of securing large settlements. These meritless lawsuits and settlements distort the marketplace.

The modern financial services sector is highly dependent upon innovation for business growth and customer service.¹ We continuously engage in the creation and integration of technology into systems that provide our customers access to financial services and products they rely on every day, such as online and mobile banking, worldwide ATM networks and electronic exchanges capable of executing trades, virtually anywhere, anytime.

¹ See, e.g., Robert C. Merton, *Financial Innovation and Economic Performance*, 4 J. Applied Corp. Fin. 12 (1992); Merton H. Miller, *Financial Innovation: The Last Twenty Years and the Next*, 21 Fin. and Quantitative Analysis 459 (1986).

Fundamental to the operation of the financial services sector is the interoperability of complex financial systems that facilitate the movement of data relating to every type of financial transaction, from accurate customer account information, to complex securities trades, to credit and debit card transactions, to over-night electronic transfers of funds, between and among financial institutions and the federal reserve, federal home loan banks and other global financial and monetary institutions.² The network of financial technology infrastructure is so fundamental that it has been designated as critical national infrastructure by the Department of Defense under the “Financial Services Defense Sector Critical Infrastructure Protection (CIP) Program.” The CIP Program refers to the safeguarding of systems and assets essential to the minimum operation of the economy and government.³

Given the importance of the financial services sector to the nation’s economy and infrastructure, it is important that the patent system work for this industry. Currently, it does not. Instead, the confluence of sector interoperability, frequent forum shopping, and a lack of quality prior art – particularly in the area of business method patents – has conspired to leave financial firms, from the smallest community bank, local credit union or insurance agent, to the largest global companies, mired in meritless litigation over patents of dubious quality. This litigation has a direct impact on consumers as capital that could be deployed in our communities is tied up in court costs and settlements.

Historically, traditional business methods and related systems to implement those business methods were not patented in any significant quantity.⁴ This was profoundly changed by the Federal Circuit’s 1998 decision in *State Street v. Signature Financial Group*.⁵ In *State Street*, “the Federal Circuit held that the fact that an invention could be characterized as a ‘business method’ was not a bar to patentability, and thereby

² Robert M. Hunt, *Business Method Patents and U.S. Financial Services*, Federal Reserve Bank of Philadelphia, Working Paper No. 08-10, at 6-10 (2009).

³ Defense Finance and Accounting Service, <http://www.dfas.mil/more/fsscip.html>. In addition to banking and finance, the other industries deemed critical to national infrastructure under the CIP Program include telecommunications, energy, transportation, water systems and emergency services.

⁴ For example, the Supreme Court had repeatedly held that using a computer to perform a business algorithm was generally not patentable. *E.g.*, *Parker v. Flook*, 437 U.S. 584 (1978); *Gottschalk v. Benson*, 409 U.S. 63 (1972).

⁵ 149 F.3d 1368 (1998).

laid to rest what had been the so-called business method exception to patentability.”⁶ As a result of this decision, the U.S. patent system has seen an explosion in applications for business method patents. “Between 1997 and 1999 new applications for business method patents tripled, and have more than tripled since then. By the end of 2009 some 11,000 new applications for patents on business methods were being filed each year, which suggests there will be a significant growth in the number of patents being granted. Over 40,000 of these applications are currently pending.”⁷

This proliferation of business method patents has, in turn, resulted in a flood of patent litigation in the financial services industry.

Professor Josh Lerner of the Harvard Business School has empirically studied litigation in the financial services industry. He found that the “risk of patent litigation [in financial services] is far greater than that in other fields.”⁸ Specifically, Professor Lerner concluded:

[F]inancial patents are being litigated at a rate 27 to 39 times greater than that of patents as a whole. Even relative to the most extensively litigated major category of patents (drugs and health), the rate is more than an order of magnitude higher. The rates are also far greater than that in the early years of an emerging industry where the extent and breadth of patent protection was initially ambiguous, biotechnology.⁹

What is more, due to the interoperability requirements referred to earlier, NPEs, are increasingly exploiting the current system to hold hostage entire classes of industry players in a single lawsuit. Nearly ninety percent of infringement cases against the top 20 banks name multiple financial services companies as defendants, often including as many as 20, 40 or even 60 institutions in a single action.

⁶ Stroock Special Bulletin, *Business Methods Under Attack – Is State Street in Jeopardy*, at 2 (Feb. 27, 2008) (available at <http://www.stroock.com/SiteFiles/Pub592.pdf>).

⁷ Hunt, *supra* note 4, at 3.

⁸ Josh Lerner, *The Litigation of Financial Innovations*, Harvard Business School, Working Paper 09-027, at 14 (2008).

⁹ *Id.* at 2. Professor Lerner concluded that the rate of litigation of biotechnology patents in the early years of such litigation was one-fifth the rate of litigation in the financial services industry today. *Id.* at 14.

There is no shortage of evidence of abuse in this space, and while I would be happy to provide the committee with papers from our regulators, quotes from various courts including the United States Supreme Court or the words of the senior staff of the PTO, the facts have been well-established over the years and I'm not aware of anyone who disagrees with our analysis.

It is important to note that business method patents are not "bad" per se, but do lend themselves to abuse. An example I would share are patents asserted by Phoenix Licensing. In this case, scores of banks and insurance companies were sued in the Eastern District of Texas for infringing a method patent related to marketing. As I understand it, most if not all have settled, but the patents in suit covered printing marketing material at the bottom of or on the back of billing statements. For years, financial firms had been using statement stuffers and it was inevitable that some would migrate to printing the marketing material directly onto the statement. It is difficult to see anything novel or non-obvious that would have merited a 20 year property right.

The invalidating prior art in this case was "prior use," which is currently inadmissible at the PTO during reexaminations, so companies settled rather than bear the costs of lengthy court proceedings.

In this instance, as in many others, it is the combination of low quality business method patents, the structural requirements of the financial services industry and the emergence of NPEs who exploit shortcomings in the current patent system that has been so costly to all sectors of the financial services industry and our customers. These costs continue to grow at an alarming rate.

We were, therefore, very pleased that the House draft which was circulated last week (draft SLS_132) included language similar to language inserted into S. 23 establishing an opposition proceeding at the PTO to review qualified business method patents against the best prior art. Under the program, the PTO:

- Determines whether a patent is qualified business method patent;

- Undertakes a review in a maximum of one year;
- Examines the patent against the best available prior art, including evidence of prior use, sale or offer for sale; and
- Winds down the program after 4 years of establishment.

The Senate language created the strong presumption of a stay of district court litigation once the PTO agrees to undertake a review. The House draft bill improves on this “stay” language by requiring the Federal Circuit to review stay appeals “de novo”. It is our belief that the stay should be mandatory, but short of that we appreciate this significant improvement designed to ensure that neither plaintiffs nor defendants bear the costs of parallel proceedings.

Mr. Chairman, in the run-up to the markup in the Senate, the Roundtable sent a strongly worded letter to committee members urging inclusion of the business-method patent program, while stating that the Roundtable would oppose any bill that does not include it. Our position is unchanged. We are therefore encouraged that the proposed House bill includes an enhanced version of the program.

Innovation is the engine that drives the American economy. The patent system enables this engine to work. However, the patent system must work for all sectors of the economy if America is to maintain its preeminent role as the world’s leader in innovation. We commend the House for addressing the unique challenge business methods pose to the current patent system. We look forward to working with you to ensure this legislation becomes law.

Thank you for the opportunity to testify today. I would be happy to answer any questions.