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E-Commerce Clones: Entrepreneurship or Intellectual Property Theft?

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Intellectual Property Theft?**

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By Kelly Oki*

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AN INTRODUCTION TO E-COMMERCE



Electronic commerce (e-commerce) refers to any commercial activity in which an electronic communication medium plays a central role in the exchange of money for goods and services.¹ First made available to consumers in 1991, when the Internet initially opened to commercial activity, the popularity of e-commerce among consumers has grown gradually. As Internet-security technology continued to develop in the early

* J.D., 2014, Northwestern University School of Law.

¹ Michael S. H. Heng, *Understanding Electronic Commerce from a Historical Perspective*, 12 COMM'NS OF THE ASS'N FOR INFO. SYS. 104, 105 (2003).

nineties, enhanced website functionality enabled businesses to begin selling products online.² By 2012, the U.S. Census Bureau reported that e-commerce sales accounted for approximately five percent of total retail sales.³ Today, companies such as Amazon and Zappos generate astronomical sums of annual revenue and represent the pinnacle of success for many entrepreneurs hoping to launch similar ideas on the Internet. Of these many hopeful entrepreneurs, the people behind Rocket Internet (Rocket) are arguably the most successful in building new companies based on existing business models.

German brothers—Oliver, Marc, and Alexander Samwer—are the topic of much conversation among those interested in technology startups. Operating through their startup incubator, Rocket Internet, the Samwers’ business model is simple: identify existing, successful business models in the United States and imitate them internationally. Claiming to be “execution” rather than “pioneer” entrepreneurs, the Samwer brothers have successfully cloned Ebay, Airbnb, eHarmony, Pinterest, Amazon, and Zappos, among others.⁴ Though the Samwers’ strategy is to operate these imitation websites in foreign countries, and thus avoid going head-to-head with their American counterparts, the Samwers often eventually sell the clones to the imitated companies.

Many entrepreneurs revile the Samwers as unimaginative concept thieves; however, the Samwers maintain that there are many imitation websites, and that what sets them apart is the efficient execution of the imitated ideas. Additionally, the Samwers point out that many of the most popular technologies, such as Google, iPods, and Facebook were clones of other, less successful products.⁵ Even technology giants like Google and Apple were not the first to create the products that fueled their growth and success. For example, despite what many may believe, Google was not the first Internet search engine, and Apple did not invent the MP3 player, the touchscreen smartphone, or the tablet computer.⁶ Oliver Samwer explains that “most innovations come on top of other innovations,”⁷ and that their approach should be treated no differently than any other invention that has improved upon preexisting technology.

This Comment first analyzes and discusses the successes of the Samwer brothers and their startup incubator, Rocket Internet. It further evaluates why intellectual property protection, specifically a business method patent, is not available to protect the business ideas of the companies they clone. Lastly, this Comment explores whether intellectual property protection should be offered to companies with novel and creative ideas, or whether protection would retard, rather than promote, innovation.

² *History of Ecommerce*, ECOMMERCE-LAND, http://www.ecommerce-land.com/history_ecommerce.html (last visited Feb. 16, 2014).

³ U.S. CENSUS BUREAU, DEP’T OF COMMERCE, QUARTERLY RETAIL E-COMMERCE: 2ND QUARTER 2012 (2012).

⁴ Caroline Winter, *How Three Germans Are Cloning the Web*, BLOOMBERG BUSINESSWEEK (Feb. 29, 2012), <http://www.businessweek.com/articles/2012-02-29/the-germany-website-copy-machine>.

⁵ David Meyer, *The Ethics of Cloning: Why ‘Original’ Isn’t Always Essential*, GIGAOM (Sept. 3, 2012, 9:18 AM), <http://gigaom.com/europe/the-ethics-of-cloning-why-original-isnt-always-essential/>.

⁶ *Id.*; see Max Chafkin, *Lessons from the World’s Most Ruthless Competitor*, INC. MAGAZINE (May 29, 2012), <http://www.inc.com/magazine/201206/max-chafkin/oliver-samwer-european-king-of-the-company-cloners.html>.

⁷ See Chafkin, *supra* note 6.

I. A HISTORY OF ROCKET INTERNET AND THE SAMWER BROTHERS

¶15 The Samwer brothers conceived of the idea behind Rocket Internet in 1999, when they noticed both the absence of an online auction site in the German marketplace and the potential for one to succeed.⁸ Germany's retail laws imposed harsh restrictions on retail discounts, and the Samwers believed online auctions would allow consumers to circumvent those laws.⁹ When Oliver, Marc, and Alexander's efforts to pitch their ideas to eBay's executives were rebuffed, the brothers began developing their own online auction site, Alando. Alando was incredibly successful, and just one hundred days after going live, eBay purchased Alando from the Samwers for £35 million.¹⁰

¶16 Despite the success of Alando, the Samwers did not launch Rocket Internet, their Berlin-based incubator, for eight years following Alando's debut. The Samwers spent that time investing in various German technology startups, all of which were based on business models that had proven to be successful in the United States.¹¹ These successes led to the development of the Samwers' own business model: imitate preexisting, high-growth, U.S.-based Internet companies, launch these startups in foreign countries, and often sell the company back to the imitated entity. This model is based on highly efficient and ruthless execution, providing founders with operational assistance and access to capital plus as little as 2–10% equity in their companies.¹² Most of the equity in these technology startups belongs to Rocket, with a substantial portion of the rest belonging to investors.¹³ Many have criticized the Samwers' approach, suggesting that they take advantage of founders who are faced with choosing between receiving little equity in their own company and not being able to start one at all.¹⁴

II. THE DEBATE: IS THIS ENTREPRENEURSHIP OR THEFT?

¶17 Oliver Samwer admits innovation is not the driving force behind Rocket Internet's business model. In an interview with Wired Magazine, Oliver Samwer discussed how "[his] advantage is never that [he's] the first . . . [his] advantage is that [Rocket] build[s] faster and better in more instances than anyone else."¹⁵ One of Rocket's managing directors, Alexander Kudlich, explains that while ideas are important, "innovation is more than design and the first idea."¹⁶ Florian Heinemann, another of Rocket's managing directors, describes innovation as something that happens "on a conceptual level, on an idea level, but also on an operational level."¹⁷ Both Kudlich and Heinemann emphasize that the Samwers' approach incorporates many of the elements and risks of

⁸ Matt Cowan, *Inside the Clone Factory: The Story of Germany's Samwer Brothers*, WIRED (Mar. 2, 2012), <http://www.wired.co.uk/magazine/archive/2012/04/features/inside-the-clone-factory?page=all>.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² See Chafkin, *supra* note 6.

¹³ *Id.*

¹⁴ Bernard Leong, *Rocket Internet: Is There a Method to Its Madness or Is It Just Bad for Innovation*, TECHCRUNCH (Sept. 16, 2012), <http://techcrunch.com/2012/09/16/rocket-internet-is-there-a-method-to-its-madness-or-is-it-just-bad-for-innovation/>.

¹⁵ Cowan, *supra* note 8.

¹⁶ See Chafkin, *supra* note 6.

¹⁷ Cowan, *supra* note 8.

entrepreneurship, including finding both structurally sustainable business models and the right market to enter, and hiring the right staff to run the operation.¹⁸

¶18 It is the position of the Samwers, and a small minority of entrepreneurs, that they should reap the rewards of the risks they take in implementing the ideas of others.¹⁹ Additionally, the Samwers emphasize the importance of idea execution for their success. Business incubators such as Team Europe, Springstar, Atlantic Ventures, and Found Fair are all examples of “Samwer wannabes,” or entrepreneurs that hope to imitate existing business models in different markets.²⁰ However, these fledgling incubators cannot begin to match the accomplishments of Rocket, which boasts a success rate of between 70 and 80 percent for all investments.²¹ Oliver Samwer’s colleagues attribute Rocket’s success to his discipline, hard work, and tendency to work “until he wins.”²² This diligence and tenacity enabled Rocket to create successful international clones of Square, Fab, Zappos, and Amazon in less than six months.²³

¶19 Despite the incredible success of Rocket Internet and the Samwers thus far, the sustainability of their business model has recently been called into question.²⁴ Some in the startup industry predict the eventual collapse of the empire the Samwers have built.²⁵ While many have praised the Samwers’ emphasis on business-strategy execution, Rocket is shutting down some of their operations due to poor returns. Ironically, those who have examined the few failures of the Samwers suggest their excellence in execution could be the cause of their downfall, rather than their success.²⁶ Where the Samwers excel at pouring time, energy, and resources into developing the IT platforms and operations of existing businesses, they are considerably less successful at implementing the customer service aspects of these companies.²⁷ Zappos is known for its “customer-centric” culture, which requires not only the right personnel, but also the continued commitment from its leaders to internally cultivate this culture.²⁸ As such, critics suggest Rocket’s Zappos clone, Zalora, is failing due to its customer-service shortcomings, noting that excellent customer service is “not something that you can do within three months using a spreadsheet.”²⁹

¹⁸ See *id.*; see also Chafkin, *supra* note 6.

¹⁹ See Chafkin, *supra* note 6.

²⁰ See *id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ See Leong, *supra* note 14.

²⁵ *Id.*

²⁶ See *id.* (“[T]hey are excellent in execution of launching new Internet companies whether—web services or e-commerce companies—but fall short in building businesses with real value. That’s why we are hearing so many bad reports, and mainly in the space of customer complaints.”).

²⁷ *Id.*; see Colin Charles, *My Take on Rocket Internet*, COLIN CHARLES AGENDA (May 9, 2012), <http://www.bytebot.net/blog/archives/2012/09/05/my-take-on-rocket-internet>.

²⁸ See Leong, *supra* note 14.

²⁹ *Id.*

III. DOES A HISTORY OF IMITATION EXIST IN TECHNOLOGY?

¶10 Many entrepreneurs, even those that disparage the Samwers' business methods, admit that derivative ideas are the basis of innovation.³⁰ In fact, much of intellectual property law centers on the idea that protection of intellectual property must be on balance with encouraging innovation. Oliver Samwer claims that "most innovations come on top of other innovations,"³¹ evidence of which is found in the history of America's biggest technology trends. For example, as mentioned previously, Google was not the first search engine, and Apple did not invent the MP3 player, the touchscreen smartphone, or the tablet computer.³² The Samwers argue that the development of startup clones merely creates competition for online retailers, which benefits any healthy marketplace.³³

¶11 In fact, technology's progression enables such effective imitation. As technology has continued to develop, the pace of imitation has increased substantially.³⁴ As Professor Oded Shenkar of Ohio State University points out: "[A] successful Internet startup can be knocked off in an afternoon. Most will be knocked off in a matter of months."³⁵ However, despite both the history of cloning in the technology field and the efforts of other entrepreneurs to copy the Samwers' business model, many still view the Samwers as merely "clone kings"—intellectual property thieves without original ideas.³⁶

IV. WHAT KIND OF INTELLECTUAL PROPERTY PROTECTION IS AVAILABLE FOR INNOVATORS?

A. Trade Dress

¶12 Rocket invested in StudiVZ, the German imitation of Facebook.³⁷ In 2009, Facebook sued StudiVZ for trade dress infringement, alleging a substantial degree of visual and functional similarity to Facebook's user interface.³⁸ Facebook was ultimately unsuccessful in German courts, and settled outside of American courts.³⁹ This case illustrates the high standards courts impose for proving trade dress infringement.

¶13 Trade dress has been defined as "the total image of a product, [which] include[s] features such as size, shape, color or color combinations, texture, graphics, or even particular sales techniques."⁴⁰ Under the Lanham Act, to prevail on a claim for trade dress infringement, a plaintiff must prove:

³⁰ See Cowan, *supra* note 8.

³¹ Chafkin, *supra* note 6.

³² Meyer, *supra* note 5; *see also* Chafkin, *supra* note 6.

³³ Chafkin, *supra* note 6.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ Cowan, *supra* note 8.

³⁸ Facebook, Inc. v. Studivz Ltd., No. C 08-3468 JF (HRL), 2009 WL 1190802, at *1 (N.D. Cal. May 4, 2009).

³⁹ See Justin Smith, *Facebook Settles Suit Against StudiVZ, but Germans Already Moving to Facebook Anyways*, INSIDE FACEBOOK (Sept. 10, 2009), <http://www.insidefacebook.com/2009/09/10/facebook-settles-suit-against-studivz-but-germans-already-moving-to-facebook-anyway>.

⁴⁰ John H. Harland Co. v. Clarke Checks, Inc., 711 F.2d 966, 980 (11th Cir. 1983); *see* SK & F Co. v. Premo Pharm. Labs., Inc., 481 F. Supp. 1184, 1187 (D.N.J. 1979) (stating that "[t]rade dress is a complex

1. The trade dress of the two products is confusingly similar,
2. The features of the trade dress are primarily nonfunctional, and
3. The trade dress has acquired secondary meaning.⁴¹

¶14 Although the court acknowledged that the design of a website could be eligible for trade dress protection, Facebook’s design was not eligible because the design was simple and not highly remarkable.⁴² An analysis of trade dress protection suggests that while some companies may be able to protect the “packaging” of their ideas, suing under a theory of trade dress infringement will not protect the underlying business model.

B. Trade Secrets

¶15 Trade secrets represent another form of intellectual property protection that innovators could potentially pursue to protect their business concepts. Broadly speaking, a trade secret is “any confidential business information that provides an enterprise a competitive edge.”⁴³ This confidential business information could include, among other types of confidential proprietary information, formulas, recipes, sales and marketing strategies, and manufacturing information.⁴⁴ However, taking into account the ease by which imitators can reverse engineer websites, even without any proprietary information from the original site, trade secrets seem to have little place in the Internet-startup field.⁴⁵

¶16 Further, while most states have enacted laws fashioned at least in part after the Uniform Trade Secrets Act (UTSA), which provides a legal framework for the improved protection of trade secrets within the United States,⁴⁶ e-commerce proprietors wishing to protect their trade secrets from extraterritorial misappropriation usually lack federal protection.⁴⁷ Before Congress passed the Economic Espionage Act of 1996 (EEA), advocates for federal protection of trade secrets argued that a federal law would facilitate trade secret protection in international trade—an area of uniquely federal concern.⁴⁸ Yet even after the EEA’s adoption, multinational companies face great difficulty in protecting trade secrets internationally. Because of the EEA’s limited extraterritorial reach, a U.S.-based company will likely be unable to bring a cause of action for trade secret misappropriation against a foreign company, unless “an act in furtherance of the offense

composite of features” including, *inter alia*, size, color, texture, and graphics, which must “be considered together, not separately”), *aff’d*, 625 F.2d 1055 (3d Cir. 1980).

⁴¹ *John H. Harland Co.*, 711 F.2d at 980 (quoting *Black & Decker Co. v. Ever-Ready Appliance Mfg. Co.*, 518 F. Supp. 607, 616 (E.D. Mo. 1981), *aff’d*, 684 F.2d 546 (8th Cir. 1982)); *see* 15 U.S.C. § 1125(a) (2012).

⁴² *Facebook*, 2009 WL 1190802, at *1.

⁴³ *What Is a Trade Secret?*, WORLD INTELLECTUAL PROP. ORG., http://www.wipo.int/sme/en/ip_business/trade_secrets/trade_secrets.htm (last visited Feb. 16, 2014).

⁴⁴ *Id.*

⁴⁵ *See* Chafkin, *supra* note 6.

⁴⁶ *See* Christopher Rebel J. Pace, *The Case for a Federal Trade Secrets Act*, 8 HARV. J. L. & TECH. 427, 432 n.17, 433 (1995).

⁴⁷ *See id.* at 442; 18 U.S.C. §§ 1831–1839 (applying only to companies incorporated in the United States, or in the alternative, to domestic acts in furtherance of an applicable offense).

⁴⁸ Pace, *supra* note 46, at 449.

was committed in the United States.”⁴⁹ Because of this domestic-conduct requirement, federal trade secret protection is especially limited for e-commerce.

¶17 Although the United States has entered into various international trade agreements, such as the North American Free Trade Agreement (NAFTA) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), these agreements only mandate that signatory nations provide a minimal level of protection for intellectual property existing within their borders.⁵⁰ In the end, this minimal level of foreign protection does not make up for the EEA’s extraterritorial limitations, making trade secret protection an inadequate remedy for those wishing to combat imitation startups.

C. Copyright

¶18 While the individual expression of an author’s ideas is copyrightable, the underlying idea is not eligible for copyright protection.⁵¹ Courts have recognized that copyright law protects computer programs and software as “literary works,”⁵² but it is unclear whether a website would fit into the category of copyrightable expression. As the court explained in *Computer Associates International, Inc. v. Altai, Inc.*,

Those aspects of a work, which “must necessarily be used as incident to” the idea, system or process that the work describes, are . . . not copyrightable. . . . [Therefore] those elements of a computer program that are necessarily incidental to its function are similarly unprotectable.⁵³

Under that theory, the ideas, systems, and processes underlying the computer program, or in this case a website, are not copyrightable, and neither are those aspects that are necessary to its function.⁵⁴ Further, applying the court’s “abstraction test,” which distinguishes idea from expression,⁵⁵ it is relatively clear that while the design elements of a website are copyrightable expression, the underlying business idea is not.

D. Business Method Patent

¶19 The United States Patent and Trademark Office (USPTO) recognizes three types of patents: utility patents, design patents, and plant patents.⁵⁶ Business method patents are categorized as utility patents, which the USPTO grants to “anyone who invents or discovers any new process, machine, article of manufacture, or composition of matter, or

⁴⁹ 18 U.S.C. § 1837(2) (1996).

⁵⁰ Pace, *supra* note 46, at 450.

⁵¹ See JULIE COHEN ET AL., COPYRIGHT IN A GLOBAL INFORMATION ECONOMY 215 (3d ed. 2010).

⁵² *Id.*

⁵³ *Computer Assocs. Int’l, Inc. v. Altai, Inc.*, 982 F.2d 693, 704–05 (2d Cir. 1992) (quoting *Baker v. Selden*, 101 U.S. 99 (1879)).

⁵⁴ *Id.*

⁵⁵ See *id.* at 706–07.

⁵⁶ *Patents*, U.S. PATENT & TRADEMARK OFFICE, <http://www.uspto.gov/patents/index.jsp> (last visited Oct. 11, 2014).

any new and useful improvement thereof.”⁵⁷ Additionally, a business method must be novel, useful, and nonobvious to qualify for patent protection.⁵⁸

V. THE EXPANSION OF PATENTABLE SUBJECT MATTER UNDER 35 U.S.C. § 101

¶20 Prior to the court’s decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, the USPTO generally considered methods of doing business not to be patentable subject matter.⁵⁹ The USPTO first discussed the patentability of business methods in 1869, when bookkeeping methods were considered “contrary to the spirit of the patent law construed by the Office,” and thus unpatentable.⁶⁰ The “business-method-exception doctrine,” which described business methods as ineligible for patent protection, arose out of dicta in *Hotel Security Checking Co. v. Lorraine*. There, since the subject matter of the claims—a system of bookkeeping—was clearly not a “machine, manufacture or composition of matter,” the court concluded that the system must therefore qualify as a “new and useful art” to be patentable. The court then noted, “A system of transacting business disconnected from the means for carrying out the system is not, within the most liberal interpretation of the term, an art.”⁶¹ From this, the foundation of the business-method-exception doctrine—that business methods are per se unpatentable—was born.

A. The 1980s

¶21 But as technology developed in the United States, the scope of patentable subject matter correspondingly expanded.⁶² Reaching its apex in the 1980s, this judicial trend resulted in a number of decisions providing a more liberal basis for determining what constitutes statutorily patentable subject matter.⁶³ For instance, in *Diamond v. Chakrabarty*, the United States Supreme Court broadly construed “Inventions Patentable” to “include anything under the sun that is made by man,” with the exception of “laws of nature, physical phenomena, and abstract ideas.”⁶⁴ However, the Court did not address the issue of whether business methods are subject to patent protection.⁶⁵

¶22 With limited Supreme Court guidance, a Delaware District Court confronted the business-method-exception doctrine in *Paine, Webber, Jackson & Curtis, Incorporated v.*

⁵⁷ *Id.*

⁵⁸ Daniel A. Tysver, *Patent Requirements*, BITLAW, <http://www.bitlaw.com/patent/requirements.html> (last visited Oct. 11, 2014).

⁵⁹ MIKU MEHTA & LAURA MOSKOWITZ, SUGHRUE MION, PLLC, BUSINESS METHOD PATENTS IN THE UNITED STATES: A JUDICIAL HISTORY & PROSECUTION PRACTICE 5 (2012), available at <http://www.sughrue.com/files/publication/54011fba-0904-4dfe-83af-e5c4b0d1c538/presentation/publicationattachment/5869b571-51c7-451b-bbd1-ed552fe8edc6/businessmethodpatentsaippioproprac.pdf>; see *State Street Bank & Trust Co. v. Signature Fin. Grp., Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

⁶⁰ MEHTA & MOSKOWITZ, *supra* note 59, at 2 (quoting *Ex parte Abraham*, Dec. Comm’r Pat. 59 (1869)).

⁶¹ *Hotel Security Checking Co. v. Lorraine*, 60 F. 467, 469 (2d Cir. 1908).

⁶² MEHTA & MOSKOWITZ, *supra* note 59, at 5.

⁶³ *Id.*

⁶⁴ 447 U.S. 303, 308 (1980) (quoting S. REP. NO. 82-1979, at 5 (1952); H. R. REP. NO. 82-1923, at 6 (1952)).

⁶⁵ See generally *id.*

Merrill Lynch, Pierce, Fenner & Smith, Incorporated.⁶⁶ The district court held that although the disputed patent included a business method, the business-method-exception doctrine did not invalidate the patent because the business method was performed by a computer, rather than by hand.⁶⁷ While this narrow application of the business-method-exception doctrine did not explicitly confront the issue of business method patentability, it nevertheless highlights the necessary evolution of traditional legal principles in light of modern innovation.

B. The 1990s

¶23 Though the courts expanded the scope of patentable subject matter throughout the 1980s, no case directly addressed the patentability of business methods.⁶⁸ However, a series of cases during the 1990s, all relating to computer software, resulted in the further expansion of patentable subject matter.⁶⁹ These cases ultimately served as the precursor for the eventual inclusion of business methods in the realm of patentable subject matter.

¶24 In 1994, the Federal Circuit decided the first of these cases, *In re Alappat*.⁷⁰ The court determined that the practical application of a mathematical algorithm qualified as a useful, concrete, and tangible result when applied in a machine that produced a smooth, waveform display on a digital oscilloscope.⁷¹ Similarly, in *In re Lowry*, the Federal Circuit held that a data-processing system, utilized for the storage, use, and management of information in computer memory, was patentable subject matter.⁷² And only one year later, the Federal Circuit in *In re Beauregard*⁷³ determined that computer programs constitute patentable subject matter as articles of manufacture, as long as the claim involves a computer-readable medium accompanied by instructions for causing a particular computer operation.⁷⁴ In other words, if software involves a computer-readable medium and has instructions for causing a specific result, it should be considered an article of manufacture, and is therefore patentable under § 101.⁷⁵

VI. THE EXPANSION OF PATENTABLE SUBJECT MATTER TO INCLUDE BUSINESS METHODS

¶25 The Federal Circuit's series of decisions in the mid-1990s vastly expanded the scope of patentable subject matter. However, much like the series of cases in the 1980s, these cases failed to address whether business methods, independent of a computer-readable medium or data carrier, are patentable under § 101.⁷⁶ In 1998, the Federal Circuit finally directly addressed the issue of business method patentability in *State Street*

⁶⁶ 564 F. Supp. 1358, 1369 (D. Del. 1983).

⁶⁷ *Id.*

⁶⁸ MEHTA & MOSKOWITZ, *supra* note 59, at 5.

⁶⁹ *Id.*

⁷⁰ 33 F.3d 1526, 1545 (Fed. Cir. 1994).

⁷¹ *Id.*

⁷² 32 F.3d 1579, 1584–85 (Fed. Cir. 1994).

⁷³ 53 F.3d 1583 (Fed. Cir. 1995).

⁷⁴ *See id.*; *see also* MEHTA & MOSKOWITZ, *supra* note 59, at 6.

⁷⁵ MEHTA & MOSKOWITZ, *supra* note 59, at 6.

⁷⁶ *Id.*

*Bank & Trust Company v. Signature Financial Group, Incorporated.*⁷⁷ Following *State Street*, several influential case decisions provided further guidance in determining both the scope of the business method patent and the applicable test for business method patentability.

A. *State Street Bank & Trust Co. v. Signature Financial Group, Inc.* (1998)

¶26 In *State Street*, the Federal Circuit held that business methods are patentable if they produce a concrete and tangible result.⁷⁸ The business method at issue involved the transformation of data through a series of mathematical calculations that produced a result. Because it created a useful, concrete, and tangible result, the business method constituted a patentable practical application of a mathematical algorithm.⁷⁹

¶27 Following *State Street*, patents were no longer limited to physical embodiments. Business methods could qualify for patent protection as long as they met the procedural and substantive requirements of patentability.⁸⁰ However, because the business method in *State Street* involved a machine performing a business method through the use of a mathematical algorithm, the business method was considered a statutory machine under § 101.⁸¹ Therefore, while the *State Street* opinion rendered the business-method-exception doctrine obsolete, the patent in question referred only to business methods claimed as statutory machines.⁸² As a result, it was still unclear whether patent protection extended to a business method as process claim not involving a statutory machine.⁸³

¶28 In response to *State Street*, the USPTO began granting patent applications for everything from simple software features, such as Amazon's "One-Click" system, to exceedingly broad methods, such as the "process of exercising a cat with a laser pointer."⁸⁴ Many who were opposed to making business methods eligible for patent protection viewed the *State Street* decision as "an example of judicial activism that introduced patents into a field where patenting was unwanted and unnecessary."⁸⁵ Overall, the *State Street* opinion has been widely criticized as "a source of increasing and expensive litigation, especially in Internet applications," due to the flood of new patents entering the market, many of which being extremely broad in scope.⁸⁶

⁷⁷ *Id.* at 7; *State Street Bank & Trust Co. v. Signature Fin. Grp., Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

⁷⁸ *State Street*, 149 F.3d at 1373.

⁷⁹ *Id.*

⁸⁰ See Larry Downes, *Supreme Court Hedges on Business Method Patents*, CNET (June 28, 2010), http://news.cnet.com/8301-13578_3-20009046-38.html (discussing that the procedural and substantive requirements for patents provide that the proposed invention must be novel, useful, and not obvious).

⁸¹ See MEHTA & MOSKOWITZ, *supra* note 59, at 7–8.

⁸² *Id.* at 7.

⁸³ *Id.*

⁸⁴ Downes, *supra* note 80 ("A patent was even granted for the process of receiving a patent."); see Steven J. Frank, *The Death of Business-Method Patents*, IEEE SPECTRUM (Mar. 1, 2009), <http://spectrum.ieee.org/at-work/innovation/the-death-of-businessmethod-patents>.

⁸⁵ John F. Duffy, Comment, *Why Business Method Patents?*, 63 STAN. L. REV. 1247, 1247 (2011).

⁸⁶ Downes, *supra* note 80.

B. *AT&T v. Excel Communications* (1999)

¶29 In *AT&T v. Excel*, the Federal Circuit again decided a case that involved the patenting of a business method, this time clarifying that a business method is patentable as a process, not just as a statutory machine, under § 101.⁸⁷ The court found that a process that brings about a useful, concrete, and tangible result is patentable under § 101, despite the fact that it does not involve a physical transformation.⁸⁸

C. *In re Bilski* (2008)

¶30 Relying on *Diamond v. Diehr*,⁸⁹ the *In re Bilski* court sought to determine whether a patent applicant's method of hedging risk in commodities trading was a fundamental principle.⁹⁰ The court distinguished patent applicants seeking to preempt the use of fundamental principles from those seeking patents to do the same, but as a step in a particular process.⁹¹ Ultimately, the court sought to determine whether granting the patent would preempt all uses of the fundamental principle.⁹²

¶31 In deciding whether the risk-hedging method was patentable subject matter, the court reaffirmed the use of the “machine-or-transformation” test.⁹³ This test defines patentable subject matter under § 101 as something that (1) is tied to a particular machine or apparatus, or (2) transforms a particular article into a different state or thing.⁹⁴ Applying the machine-or-transformation test, the court rejected the patent because the method was neither tied to a particular machine nor did it affect any transformation of matter in the physical world.⁹⁵ With this decision, the *In re Bilski* court also rejected the “useful, concrete, and tangible result test,” applied in both *In re Alappat*⁹⁶ and *State Street*,⁹⁷ in favor of the machine-or-transformation test.

¶32 Many viewed the Federal Circuit's decision in *In re Bilski* as an abrogation of *State Street*.⁹⁸ The use of the machine-or-transformation test in lieu of the “useful, concrete, and tangible result” test would strictly limit the patentability of business methods, and would “sharply circumscribe[] the availability of patent protection for most software claims.”⁹⁹ Many feared that the exclusive application of the machine-or-transformation test would have “gutted [the patent system] . . . and put up too many hurdles to getting

⁸⁷ *AT&T v. Excel Commc'ns Corp.*, 172 F.3d 1352, 1355–58 (Fed. Cir. 1999).

⁸⁸ *Id.*; see MEHTA & MOSKOWITZ, *supra* note 59.

⁸⁹ 101 S. Ct. 1048 (1981) (holding that a mathematical algorithm may be deserving of patent protection if it is applied to a known structure or process).

⁹⁰ *In re Bilski*, 545 F.3d 943, 953 (Fed. Cir. 2008).

⁹¹ *Id.*

⁹² *Id.* at 954.

⁹³ See, e.g., *Diamond v. Diehr*, 450 U.S. 175 (1981); *Parker v. Flook*, 437 U.S. 584 (1978); *Gottschalk v. Benson*, 409 U.S. 63 (1972).

⁹⁴ *In re Bilski*, 545 F.3d at 954.

⁹⁵ *Id.* at 966.

⁹⁶ *In re Alappat*, 33 F.3d 1526, 1544 (Fed. Cir. 1994).

⁹⁷ *State Street Bank & Trust Co. v. Signature Fin. Grp. Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998).

⁹⁸ Matthew Moore, *In re Bilski and the “Machine or Transformation” Test: Receding Boundaries for Patent-Eligible Subject Matter*, 2010 DUKE L. & TECH. REV. 5, 6 (2010).

⁹⁹ Downes, *supra* note 80.

anything patented.”¹⁰⁰ However, fortunately for proponents of business method patents, Supreme Court intervention loomed on the horizon.

D. *Bilski v. Kappos* (2010)

¶33 In *Bilski v. Kappos*, the Supreme Court reexamined the risk-hedging business method’s patentability. While the Court upheld the patentability of business methods generally,¹⁰¹ it determined that the applicants’ business method was an abstract investment strategy, which did not constitute patentable subject matter.¹⁰² Most importantly, the Court additionally held that the machine-or-transformation test should not be the sole test for determining patent eligibility of a process, despite the Federal Circuit’s ruling in *In re Bilski*.¹⁰³ The Court explained that the machine-or-transformation test is “a useful and important clue, an investigative tool for determining whether some claimed inventions are processes under § 101.”¹⁰⁴ However, the use of the machine-or-transformation test as the exclusive means in determining what constitutes a “process,” as opposed to merely an important indicator, contradicted the statutory interpretation principles of § 101 set forth in prior Supreme Court decisions.¹⁰⁵

¶34 The Court cited the development of the “Information Age” as the reason that the machine-or-transformation test is no longer adequate as the sole indicator of what constitutes a patentable process.¹⁰⁶ Considering the advancements in “software, advanced diagnostic medicine techniques, and inventions based on linear programming, data compression, and the manipulation of digital signals,” the machine-or-transformation test would create uncertainty as to the patentability of these innovations.¹⁰⁷ For a process to be eligible for a patent, the machine-or-transformation test requires an innovator to have implemented the process with a particular machine, specifically devised and adapted to carry out such process, in neither a conventional nor trivial manner; or in the alternative, that the process transforms an article from one thing or state to another.¹⁰⁸ Because many software innovations are only tenuously tied to a particular machine, the implementation of the machine-or-transformation test as the exclusive means of determining patentability would not only create vast uncertainty as to what is patentable, but potentially “force[] [the lower courts] to wipe out many, many patents.”¹⁰⁹

¶35 The Court’s decision implicitly endorsed less stringent standards for business method patents.¹¹⁰ The unknown and potentially widespread repercussions of imposing a high threshold for business method patentability likely contributed to the majority’s stare

¹⁰⁰ Ashby Jones, *On Bilski: A Business-Method Patent Is Dead, Though They Live On*, WALL ST. J. L. BLOG (June 28, 2010, 1:39 PM), <http://blogs.wsj.com/law/2010/06/28/a-business-method-patent-is-dead-long-live-business-method-patents/>.

¹⁰¹ *Bilski v. Kappos*, 130 S. Ct. 3218, 3228 (2010).

¹⁰² *Id.*

¹⁰³ *Id.* at 3227.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 3226.

¹⁰⁶ *Id.* at 3227.

¹⁰⁷ *Id.*

¹⁰⁸ See Stefania Fusco, *Is In re Bilski a Déjà Vu?*, 2009 STAN. TECH. L. REV. P1, 2–4 (2009).

¹⁰⁹ Jones, *supra* note 100.

¹¹⁰ *Id.*

decisive-based holding.¹¹¹ For instance, the indirect impact on the U.S. economy caused by the mass invalidation of patents might be severe. Further, stringent standards might stymie U.S. innovation. Michael Bednarek, of Axinn Veltrop Harkrider LLP, predicts that denying patents to many of the entrepreneurs innovating in the fields of medical and computer technology would discourage those innovators from creating their products, and “would [therefore] help foreign economies at [the United States’] own expense.”¹¹²

¶36 When the Supreme Court granted certiorari, many hoped this meant the Court wished to create a higher bar for business method patents, or perhaps, to eliminate them entirely.¹¹³ However, while the Court held the method of hedging weather-based risk in commodities trading to be too abstract to be patentable, it also “ratcheted back the ruling of the Federal Circuit, possibly making business method patents easier to receive than they were before.”¹¹⁴ Some argue that the Court’s ruling in *Bilski v. Kappos*, while undoubtedly pro-patent, provides little guidance as to how lower courts should determine what constitutes patentable subject matter.¹¹⁵ Regardless, many favor judicial discretion in this context, especially those involved in e-commerce. For instance, according to John Biernacki, a partner at Jones Day, district courts “were using the Federal Circuit’s ruling to strike down a lot of patents, especially those pertaining to e-commerce. Patentees and courts now will have greater latitude.”¹¹⁶

VII. WHY DO COMPANIES DECLINE TO SEEK PATENT PROTECTION FOR THEIR BUSINESS METHODS?

¶37 Since the 1998 ruling in *State Street*, a number of companies have sought patent protection for certain business methods, many of which combine software with a business strategy. For example, Amazon obtained a patent on its “1-Click” purchase feature, a method the company developed for expediting online purchases in 1997.¹¹⁷ Granted in 1999, this patent “protects any E-commerce transaction executed with one-click using stored customer credentials to validate.”¹¹⁸

¶38 The patent has allowed Amazon to develop an extremely effective checkout system, providing a “frictionless” process in which the purchaser need not fill out credit card and shipping information.¹¹⁹ Though this streamlined purchasing system would likely benefit many online retailers, all such retailers are precluded from using this technology without a license because of the broad patent granted to Amazon. Considering the value stemming from the 1-Click patent, one might wonder why Amazon has not sought protection for its overall business concept. For instance, startup incubators

¹¹¹ See *id.* (quoting *Bilski*, 130 S. Ct. at 3239) (majority opinion) (“Rather than adopting categorical rules that might have wide-ranging and unforeseen impacts, the Court resolves this case narrowly on the basis of this Court’s decisions in *Benson*, *Flook*, and *Diehr* . . .”).

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Mike Arsenault, *How Valuable Is Amazon’s 1-Click Patent? It’s Worth Billions*, REJOINER (July 13, 2012), <http://blog.rejoinder.com/2012/07/amazon-1click-patent/>.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

like Rocket have already created imitations of Amazon in Jakarta called “Lazada,” and one in Istanbul called “Mizado.”¹²⁰

¶39 Section 101 defines patent-eligible subject matter in “expansive terms . . . as the statute was meant to ensure that ‘ingenuities receive a liberal encouragement.’”¹²¹ However, while § 101 sets forth broad patent eligibility principles, judicial precedent has outlined three specific exemptions barring patent eligibility: laws of nature, physical phenomena, and abstract ideas.¹²²

¶40 In *Bilski v. Kappos*, the Supreme Court held that the concept of hedging was an unpatentable abstract idea.¹²³ Relying on *Gottschalk v. Benson*, the Court emphasized that “a principle, in the abstract, is a fundamental truth; an original cause; a motive; these cannot be patented, as no one can claim in either of them an exclusive right.”¹²⁴ The Court reasoned that allowing *Bilski* to patent risk hedging would preclude others, even in different fields, from using this basic economic principle, and would therefore grant a monopoly over an abstract idea.¹²⁵ Thus, existing precedent likely bars companies, such as Amazon, eBay, and Zappos, from patenting their business methods because of the abstract-idea exception.

¶41 The business concepts of online auctioning and retail are fundamental principles. Allowing Amazon to patent its overall business method would essentially preclude other online retailers from conducting business, and in so doing, would grant Amazon a monopoly over a broad and abstract idea. Though many might scorn the Samwers as “Clone Kings,” in practice they are simply creating competition in the marketplace.¹²⁶ Competing businesses frequently enter new markets, prompting the original company to provide consumers with better merchandise, discounts, or customer service—or risk going out of business. The same principle applies to online retailers: simply because Amazon created its business concept online does not mean they deserve more protection than the brick-and-mortar shop owner.

A. Consider the Arguments Against Business Method Patents

¶42 If companies were allowed to patent abstract business ideas, this practice would contradict a clear constitutional mandate. The Constitution provides that patents are to be administered “to promote the Progress of . . . useful Arts,”¹²⁷ and requires a “balance between the need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance [in Science or the useful Arts].”¹²⁸

¶43 In *Bilski v. Kappos*, Justices Stevens, concurring in the judgment and joined by Justices Ginsburg, Breyer, and Sotomayor, suggested that business method patents might

¹²⁰ Chafkin, *supra* note 6.

¹²¹ *Bilski v. Kappos*, 130 S. Ct. 3218, 3236 (2010) (Stevens, J., concurring) (quoting *Diamond v. Chakrabarty*, 447 U.S. 303, 308 (1980)).

¹²² *Diamond*, 447 U.S. at 309.

¹²³ *Bilski*, 130 S. Ct. at 3228 (majority opinion).

¹²⁴ *Id.* at 3230 (quoting *Gottschalk v. Benson*, 409 U.S. 63, 93 (1972)).

¹²⁵ *Id.* at 3231.

¹²⁶ Chafkin, *supra* note 6.

¹²⁷ U.S. CONST. art. I, § 8, cl. 8.

¹²⁸ *Bilski*, 130 S. Ct. at 3252 (Stevens, J., concurring) (quoting *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989)).

not necessarily encourage business innovation.¹²⁹ Given that the competitive marketplace favors entities that use effective and efficient business methods, Justice Stevens noted, “[C]ompanies have ample incentives to develop business methods even without patent protection.”¹³⁰ Moreover, Justice Stevens discussed how granting patents for business methods potentially stifles progress rather than promotes it,¹³¹ as overly broad patent protection can “discourage research by impeding the free exchange of information.”¹³² Faced with time-consuming and expensive research, complex licensing arrangements, and potential liability for patent infringement, broad business method patents might dissuade innovators and entrepreneurs from developing their business ideas.¹³³ Categorically rejecting the patentability of business methods, Justice Stevens further noted that if business methods could be patented, almost any business decision, even minor judgments, could potentially amount to patent infringement.¹³⁴

¶44 Both the overly broad scope of business method patents and the ambiguity surrounding what constitutes patentable subject matter for a business method have prompted criticism of the continued judicial recognition of such patents. Some argue,

[P]atent laws are not intended to “create a class of speculative schemers who make it their business to watch the advancing wave of improvement and gather its foam in the form of patented monopolies, which enable them to lay a heavy tax upon the industry of the country, without contributing anything to the real advancement of the arts.”¹³⁵

¶45 Though under *Bilski v. Kappos* the business method patent still lives, courts have historically disagreed on both the necessity of business method patents to protect innovation and the danger that such patents pose to further innovation.¹³⁶ Additionally, one can make the argument that these imitation businesses actually benefit the global economy. One of the major contributions of startup incubators like Rocket is their ability to bring beneficial business concepts to the developing world, where online retailers offering goods at discounted prices do not already exist. Should those countries have to wait and hope that Amazon or eBay decide to expand into their markets? It seems only fair to allow entrepreneurs to fill needs in untapped markets. In other words, many believe that “this conversation about clones being bad loses sight of the fact that it is building the next generation of entrepreneurs.”¹³⁷

¹²⁹ *Id.* at 3254.

¹³⁰ *Id.*

¹³¹ *Id.* at 3253.

¹³² *Id.* at 3255.

¹³³ *Id.* (quoting *Lab. Corp. of Am. Holdings v. Metabolite Labs.*, 548 U.S. 124, 127 (2006) (Breyer, J., dissenting), *dismissing cert.* 370 F.3d 1354 (Fed. Cir. 2004)).

¹³⁴ *Id.* at 3256; see Clarisa Long, *Information Costs in Patent and Copyright*, 90 VA. L. REV. 465, 487–88 (2004).

¹³⁵ *Bilski*, 130 S. Ct. at 3256 (Stevens, J., concurring) (quoting *Atlantic Works v. Brady*, 107 U.S. 192, 200 (2010)).

¹³⁶ See *id.* at 3253–55 (discussing the potential effects of business method patents on innovation).

¹³⁷ Cowan, *supra* note 8.

B. In Defense of the Samwers

¶46 Though it is understandable that innovation and new ideas are highly regarded in the entrepreneurial world, to say that the Samwers are not entrepreneurs or innovators denies them credit for their myriad accomplishments. Well before founding Rocket Internet in 2007, the Samwers devised a novel business strategy, meticulously researched countries and demographics that might respond well to particular ideas, and implemented those ideas with a remarkably high success rate.¹³⁸ While businesses understandably lack appreciation for such competition, the Samwers create markets that are both accessible to once-forgotten consumers and not dominated by large corporate monopolies. Despite the sentiments of some—that Oliver, Marc, and Alexander Samwer are merely copycats in an age that reveres technological innovation—the Samwers are driving the proliferation of technological innovation and the benefits thereof, which critics often fail to realize. If other entrepreneurs were to imitate the Samwers' business strategy and execution, rather than revile it as unoriginal, perhaps more businesses would flourish, and in so doing, would create a more competitive and dynamic marketplace.

¹³⁸ Chafkin, *supra* note 6.