

REPORT

**EN BANC FEDERAL CIRCUIT PROVIDES MULTIPLE BUT
CONFLICTING VIEWS ON PATENT ELIGIBILITY
STANDARDS FOR COMPUTER-IMPLEMENTED INVENTIONS**

May 24, 2013

On May 10, a divided Federal Circuit issued a one-paragraph decision in *CLS Bank International v. Alice Corp.*, affirming the district court's ruling that the claims of Alice's patents are not directed to patent-eligible subject matter under 35 U.S.C. §101. The patents are directed to a computerized trading platform for conducting financial transactions. As characterized by Judge Lourie, the patents "share substantially the same specification and disclose and claim computerized methods, computer-readable media, and systems that are useful for conducting financial transactions using a third party to settle obligations between a first and second party so as to mitigate 'settlement risk.'"

A majority of the Federal Circuit affirmed the district court's holding with respect to the method and computer-readable media claims. However, an equally divided court affirmed the district court's holding with respect to the system claims. There is no majority opinion supporting any portion of the decision. Instead, different groups of the judges filed six separate opinions on the appropriate standard for determining the patent eligibility of computer-implemented inventions. Only the Federal Circuit's one-paragraph per curium decision has precedential effect, and none of the opinions constitutes authoritative guidance on how to determine patent eligibility of computer-implemented

inventions. The USPTO has indicated in the attached May 13 memorandum that it is making no changes at this time to its examination guidelines for computer-implemented inventions in view of the *CLS Bank* decision.

The approaches proposed in the various opinions are significantly different in many respects. As a result, they collectively offer little, if any, clear or consistent guidance, other than that future decisions of the Court are likely to be very panel-dependent. Going forward, there will soon be three new judges on the Federal Circuit who could tip the balance in favor of one of the competing approaches. It is unclear at this time whether, or when, the Supreme Court or Congress may provide additional guidance. We discuss below the different opinions and approaches advocated by the divided Federal Circuit, along with our analysis and comments on the current state of the law, and provide our recommendations on how best to proceed in view of the ongoing uncertainty.

I. The Claims In Issue

The method claims in issue are directed to a method for exchanging obligations between parties using "shadow" records maintained by a third party "supervisory institution." The steps of the method include: creating shadow records;

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updating the shadow records at the start of each day; referring transactions to the supervisory institution throughout the day, with the supervisory institution responding to each transaction in sequence by adjusting the shadow records and permitting certain transactions; and instructing exchange institutions to carry out the permitted transactions.

The computer-readable medium claims are "*Beauregard claims*"¹ that simply recite a computer readable storage medium having computer readable program code embodied in the medium for carrying out the steps recited in the method claims.

The system claims recite "a data processing system to enable the exchange of an obligation between parties." The system comprises "a data storage unit" containing the parties' shadow records, and "a computer coupled to said data storage unit" that is configured to carry out the steps set forth in the method claims. Some of the system claims also recite additional components, such as "a first party device coupled to a communications controller" so that the device can send transactions to the computer via the communications controller.

II. The District Court Decision

CLS filed suit against Alice in 2007 seeking a declaratory judgment of non-infringement, invalidity and unenforceability of four of Alice's patents. CLS moved for summary judgment asserting that all of Alice's claims were drawn to ineligible subject matter, and thus were invalid under §101. After the Supreme Court issued its decision in *Bilski v. Kappos*, 130 S. Ct. 3218

(2010),² the district court granted summary judgment in favor of CLS, holding each of the asserted claims invalid under §101.

The district court concluded that Alice's method and computer-readable medium claims were "directed to an abstract idea of employing an intermediary to facilitate simultaneous exchange of obligations in order to minimize risk." The district court held that the system claims "would preempt the use of the abstract concept of employing a neutral intermediary to facilitate simultaneous exchange of obligations in order to minimize risk on any computer, which is, as a practical matter, how these processes are likely to be applied."

III. The Federal Circuit Panel Decision

Despite the intervening Supreme Court decision in *Mayo Collaborative Services v. Prometheus*, 132 S. Ct. 1289 (2012),³ the majority of the original panel, Judges Linn and O'Malley, embraced the "coarse filter" approach to §101 set forth in the Federal Circuit's first post-*Bilski* panel decision, *Research Corp. v. Microsoft Corp.*, 627 F.3d 859 (Fed. Cir. 2010). They held "that when — after taking all of the claim recitations into consideration — it is not manifestly evident that a claim is directed to a patent ineligible abstract idea, that claim must not be deemed for that reason to be inadequate under §101." Applying that principle to Alice's claims, the majority reversed the district court and held that "[t]he asserted claims appear to cover the practical application of a business concept in a specific way, which requires computer

¹ See *In re Beauregard*, 53 F.3d 1583 (Fed. Cir. 1995).

² See our July 6, 2010 Special Report entitled, "Supreme Court Holds That The Machine-Or-Transformation Test Is Not The Sole Test For Patentability Of Process Claims And That Business Methods May Be Patentable."

³ See our April 6, 2012 Special Report entitled, "U.S. Supreme Court Again Addresses Scope of Patentable Subject Matter Under 35 U.S.C. §101."

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implemented steps of exchanging obligations maintained at an exchange institution by creating electronically maintained shadow credit and shadow debit records." Although the majority recognized that the use of a machine in the asserted claims "is less substantial or limiting than the industrial uses examined in *Diehr* (curing synthetic rubber) or *Alappat* (a rasterizer), the presence of these limitations prevents us from finding it manifestly evident that the claims are patent ineligible under § 101."⁴

IV. The Federal Circuit En Banc Decision

In granting CLS's petition for a rehearing *en banc*, the Federal Circuit asked for briefing on two questions:

- (1) What test should the court adopt to determine whether a computer-implemented invention is a patent ineligible "abstract idea"; and when, if ever, does the presence of a computer in a claim lend patent eligibility to an otherwise patent-ineligible idea?
- (2) In assessing patent eligibility under 35 U.S.C. § 101 of a computer-implemented invention, should it matter whether the invention is claimed as a method, system, or storage medium; and should such claims at times be considered equivalent for § 101 purposes?

The Federal Circuit's one-paragraph per curium decision affirms the district court's ruling without addressing either of the two questions.

Six separate opinions follow the per curium decision, and address the above questions differently. In some cases, they reach completely different conclusions. In summary, seven of the ten judges agreed that the method and computer-

readable medium claims are not directed to patent-eligible subject matter, while only five judges agreed that the system claims are not directed to patent-eligible subject matter. Eight of the ten judges agreed that all of the disputed claims should rise or fall together.

In the attached memorandum, the USPTO noted that several themes emerged from the divided opinions—(i) there is no rigid, bright-line test for subject matter eligibility, so claims must be evaluated as a whole, on a case-by-case basis, using a flexible approach; (ii) subject matter eligibility must be evaluated separately from other issues such as novelty and obviousness; and (iii) to be patent-eligible, a claimed invention must add meaningful limits to an abstract idea.

A. Judge Lourie's Concurring Opinion

Judge Lourie authored a concurring opinion, joined by four other judges, affirming the district court's ruling with respect to all the asserted claims. Judge Lourie identified at least three common themes in five Supreme Court decisions that he termed "foundational §101 jurisprudence":

- [C]laims should not be coextensive with a natural law, natural phenomenon, or abstract idea; a patent-eligible claim must include one or more substantive limitations that, in the words of the Supreme Court, add "significantly more" to the basic principle, with the result that the claim covers significantly less.
- [C]laim drafting strategies that attempt to circumvent the basic exceptions to § 101 using, for example, highly stylized language, hollow field-of-use limitations, or the recitation of token post-solution activity should not be credited.
- [T]he cases urge a flexible, claim-by-claim approach to subject-matter eligibility that avoids rigid line drawing.

⁴ *Diamond v. Diehr*, 450 U.S. 175 (1981); *In re Alappat*, 33 F.3d 1526 (Fed Cir. 1994) (en banc).

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With those themes in mind, Judge Lourie set forth a two-step approach to the §101 analysis for computer-implemented claims that focuses on "the practical likelihood of a claim preempting a fundamental concept":

(1) Assuming the claim is within one of the four patent-eligible categories set forth in §101 (processes, machines, manufactures and compositions of matter) determine whether one of the three judicial exceptions applies, e.g., "[d]oes the claim pose any risk of preempting an abstract idea?"

(2) If such a risk exists, the pertinent abstract idea must be unambiguously identified, and then "the balance of the claim can be evaluated to determine whether it contains additional substantive limitations that narrow, confine, or otherwise tie down the claim so that, in practical terms, it does not cover the full abstract idea itself."

Judge Lourie then explained that the additional substantive limitation requirement has "sometimes" been referred to as an "inventive concept," which Judge Lourie emphasized does not equate with the patentability standards of novelty or nonobviousness. Rather, according to Judge Lourie, an "inventive concept" in the §101 context refers to "a genuine human contribution to the claimed subject matter," which must be "a product of human ingenuity," and "must represent more than a trivial appendix to the underlying abstract idea."

Applying the above test to Alice's method claims, Judge Lourie concluded that the pertinent abstract idea is "[t]he concept of reducing settlement risk by facilitating a trade through third-party intermediation," and that "there is nothing in the asserted method claims that represents 'significantly more' than the underlying abstract idea for purposes of §101." Judge Lourie acknowledged the parties' agreement in the district court that all of Alice's claims, including

the method claims, should be interpreted to require electronic implementation on a computer. However, Judge Lourie argued that "the requirement for computer participation in these claims fails to supply an 'inventive concept' that represents a nontrivial, nonconventional human contribution or materially narrows the claims relative to the abstract idea they embrace." In fact, Judge Lourie argued that, but for the implied computer implementation, Alice's method claims are very similar to those found patent-ineligible in *Bilski*, and, in his opinion, "[a]dding generic computer functions to facilitate performance provides no substantial limitation and therefore is not 'enough' to satisfy §101."

Judge Lourie found Alice's computer-readable medium claims patent-ineligible for the same reasons, concluding that "they are merely method claims in the guise of a device and thus do not overcome the Supreme Court's warning to avoid permitting a 'competent draftsman' to endow abstract claims with patent-eligible status." Further, Judge Lourie viewed the system claims as not having any meaningful distinction from the method claims for purposes of a §101 analysis: "the system claims recite a handful of computer components in generic, functional terms that would encompass any device capable of performing the same ubiquitous calculation, storage, and connectivity functions required by the method claims."

He also argued that reliance on *In re Alappat* by Chief Judge Rader and others, discussed below, is misplaced and does not support patent eligibility of the particular system claims in issue:

Not only has the world of technology changed, but the legal world has changed. The Supreme Court has spoken since *Alappat* on the question of patent eligibility, and we must take note of that change. Abstract methods do not become patent-

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eligible machines by being clothed in computer language.

Thus, Judge Lourie, joined by Judges Dyk, Prost, Reyna and Wallach, would have affirmed the district court's decision with respect to all the asserted claims.

B. Chief Judge Rader's Concurrence-In-Part and Dissent-In-Part

Relying primarily on the broad language of §101 and the history and commentary surrounding the 1952 Patent Act, Chief Judge Rader took a narrower approach to the judicially created exceptions to §101. He argued that the relevant inquiry is "whether a claim includes meaningful limitations restricting it to an application, rather than merely an abstract idea."

Citing similar Supreme Court precedent, Chief Judge Rader provided several examples of what are not meaningful limitations:

- [A] claim is not meaningfully limited if it merely describes an abstract idea or simply adds 'apply it';
- [E]ven if a claim does not wholly pre-empt an abstract idea, it still will not be limited meaningfully if it contains only insignificant or token pre or post-solution activity—such as identifying a relevant audience, a category of use, field of use, or technological environment; and
- [A] claim is not meaningfully limited if its purported limitations provide no real direction, cover all possible ways to achieve the provided result, or are overly-generalized.

Chief Judge Rader also gave examples of "meaningful limitations which likely remove claims from the scope of the Court's judicially created exceptions to Section 101":

- [A] claim is meaningfully limited if it requires a particular machine implementing a process or a particular transformation of matter; and
- A claim also will be limited meaningfully when, in addition to the abstract idea, the claim recites added limitations which are essential to the invention.

With respect to computer-implemented inventions, he argued that the key to the inquiry is "whether the claims tie the otherwise abstract idea to a *specific way* of doing something with a computer, or a *specific computer* for doing something; if so, they likely will be patent eligible, unlike claims directed to *nothing more than the idea* of doing that thing on a computer." Referencing *Alappat*, he also noted that "[a] special purpose computer, i.e., a new machine, specifically designed to implement a process may be sufficient."

Applying his approach to Alice's method and computer-readable medium claims, Chief Judge Rader reached the same conclusion as Judge Lourie, though purportedly for different reasons. He concluded that the claims as a whole recite nothing more than "using an escrow to avoid risk of one party's inability to pay—an abstract concept," and do not include any meaningful limitations restricting it to an application. Rather, the claim elements "only recite the steps inherent in that concept (stated at a high level of generality) and implement those steps according to methods long used in escrows according to the record in this case."

However, applying his approach to the system claims at issue, Chief Judge Rader reached a much different conclusion: "The claims do not claim only an abstract concept without limitations that tie it to a practical application." For support, he pointed to several disclosures in the specification that he argued explain the "implementation of the recited special

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purpose computer system," as well as "numerous flowcharts that provide algorithm support for the functions recited in the claims." Indeed, he found the system claims analogous to the claims found patent eligible in *Diehr*:

Here, the claim recites a machine and other steps to enable transactions. The claim begins with the machine acquiring data and ends with the machine exchanging financial instructions with other machines. The "abstract idea" present here is not disembodied at all, but is instead integrated into a system utilizing machines.

Thus, Chief Judge Rader, joined by Judge Moore, would have affirmed the district court's ruling with respect to the method and computer readable medium claims, and Chief Judge Rader, joined by Judges Linn, Moore and O'Malley, would have reversed the district court's determination with respect to the system claims.

C. Judge Moore's Dissent-In-Part

Judge Moore wrote separately, joined by Chief Judge Rader and Judges Linn and O'Malley, to express her concern that "the current interpretation of §101, and in particular the abstract idea exception, is causing a free fall in the patent system." In particular, she indicated that Judge Lourie's approach would lead to "the death of hundreds of thousands of patents, including all business method, financial system, and software patents as well as many computer implemented and telecommunications patents." She requested the Supreme Court to take up this case because the Federal Circuit is "irreconcilably fractured over these system claims."

Judge Moore also argued that Judge Lourie's approach ignores "a mountain of precedent," including the Federal Circuit's en banc decision in *Alappat*, which she argued is consistent with *Bilski* and *Prometheus*: "The Supreme Court has never cast doubt on the

patentability of claims such as those at issue in *In re Alappat* or the system claims at issue in this case." Judge Moore would have upheld the system claims for an additional reason: they are directed to a specialized machine, i.e., a general purpose computer programed to perform particular functions. According to Judge Moore, "[t]hese are not just method claims masquerading as system claims—they are detailed, specific claims to a system of particular hardware programmed to perform particular functions."

D. Judge Newman's Concurrence-In-Part and Dissent-In-Part

Judge Newman also emphasized that the current impasse on §101 will "add to the unreliability and cost of the system of patents as an incentive for innovation." She proposed that the Federal Circuit should resolve the impasse by reaffirming three basic principles related to §101:

1. The court should hold that section 101 is an inclusive statement of patent-eligible subject matter . . . the statutory purpose of section 101, to provide an inclusive listing of the "useful arts." Then, upon crossing this threshold into the patent system, examination of the particular subject matter on the substantive criteria of patentability will eliminate claims that are "abstract" or "preemptive," on application of the laws of novelty, utility, prior art, obviousness, description, enablement, and specificity.
2. The court should hold that the form of the claim does not determine section 101 eligibility.
3. The court should confirm that experimental use of patented information is not barred—Misunderstanding of this principle appears to be the impetus for the current debate, for the popular press, and others who know better, have stated that patented subject matter cannot be further studied. This

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theory is presented to support section 101 ineligibility, on the reasoning that important discoveries should be ineligible for patenting so that they can be further studied.

With respect to the disputed claims, and consistent with point one above, Judge Newman pointed to the "coarse filter" approach set forth in *Research Corp.* and relied upon by the *CLS Bank* panel majority, commenting that "[t]his approach places inventions in the statutory framework of patentability, not merely eligibility to be considered for participation in the patent incentive system." Thus, Judge Newman would have reversed, and held that all the claims in issue are directed to patent eligible subject matter.

E. The Dissent of Judges Linn and O'Malley

Judges Linn and O'Malley (the original panel majority) focused on the record before the court. In particular, they cited the fact that no claim construction ruling was made prior to the grant of CLS's summary judgment motion, and thus "no determination has ever been made regarding how one of skill in the art would understand the claims as of the date of issuance." Thus, they emphasized that the district court was required to adopt Alice's interpretation of the claims for purposes of summary judgment, and they wrote separately to, among other things, criticize their colleagues for ignoring that point.

In particular, Judges Linn and O'Malley criticized Chief Judge Rader and Judge Moore for construing the method claims as "far broader than the system claims," and for assuming that the method claims "are sufficiently different from those system claims to merit different treatment under the Supreme Court's case law governing exceptions to 35 U.S.C. § 101." They further criticized Judge Lourie for giving the method claims their broadest possible interpretation, and

then improperly importing that breadth into the system and media claims:

By starting with a paraphrased abstraction of the claims and excluding the record evidence regarding the meaning of the claims, Judge Lourie preordains the method claims ineligible. Judge Lourie then reads into the system claims the same abstraction he felt damned the method claims.

V. Analysis

As discussed above, given the deep divide among the various members of the Federal Circuit, it is difficult to provide clear guidance with respect to the patent eligibility of computer-implemented inventions. As noted by the USPTO in its May 13 memorandum to its examiners, "at present, there is no change in examination procedure for evaluating subject matter eligibility."

There appear to be only a few issues or themes on which there is general agreement at the Federal Circuit, several of which were also mentioned in the USPTO's May 13 memorandum:

(i) there appears to be unanimous agreement that the presumption of validity applies to patents challenged under §101, and thus patent ineligibility must be proved by clear and convincing evidence;

(ii) at least a majority of the Court agrees that it is best to address patent eligibility concerns after claim construction;

(iii) there appears to be general agreement that the test for patent eligibility should be flexible, and should be made on a claim-by-claim approach analyzing each claim as a whole; and

(iv) the judges appear to all agree that patent eligibility should be analyzed separately from patentability; however, there is some degree of overlap under at least the approaches

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articulated by Chief Judge Rader and Judge Lourie.

The question of patent eligibility is most acute for financial and business method inventions. Business methods are potentially patent-eligible—the Supreme Court said so in *Bilski*—but the minimum requirements to make a business method patent-eligible are not clear. There is a degree of overlap between Judge Lourie's "significant/inventive concept" limitation standard and Chief Judge Rader's "meaningful" limitation standard. Thus, the more abstract, conceptualized and general are the disclosure and claims of a business method invention, the more likely that the claims will be found to be patent-ineligible, regardless of the analytic approach taken to evaluating patent eligibility.

The patent-eligibility question is less acute for technological inventions that are computer-implemented. For such inventions, the boundary is more firmly established by the *Flook* and *Diehr* decisions. Thus, for example, a control system for controlling an industrial process does not become patent-ineligible simply because it is computer-implemented or the control is based on a mathematical or other algorithm.

The "coarse filter" standard is appealing, but it does not find compelling support in the Supreme Court's jurisprudence. Indeed, there is a strong argument that the standard is contrary to the collective principles announced by the Supreme Court. Thus, claims that do no more than cloak an otherwise patent-ineligible business method with generic computer-implemented limitations stand the most risk of being rejected by the USPTO, or subsequently invalidated by a court. This is especially relevant for inventions lacking an early invention date—even Chief Judge Rader would be hard-pressed to say that the use of computer technology to implement business methods is not commonplace today,

particularly basic computer technology defined in terms of a "processor" and associated "memory."⁵

Finally, the era appears to have ended when *Beauregard* claims can be relied upon as a viable claiming approach to create a patent eligibility safe harbor for an otherwise ineligible method.

The Federal Circuit may revisit the issue in another case with three new judges participating, which might be enough to generate a majority opinion.⁶ Unfortunately, clarification of the law on patent eligibility, particularly with respect to computer-implemented inventions, may need to wait for the Supreme Court or Congress to provide further guidance. As Judge Moore wrote, "[t]his case presents the opportunity for the Supreme Court to distinguish between claims that are and are not directed to patentable subject matter." Thus, we will continue to monitor the relevant case law and report on further developments.

VI. Recommendations

These are undeniably uncertain times in the world of patent eligibility, and we cannot provide any bright-line guidance on when a computer-implemented invention is patent-eligible subject matter. That said, there are some basic principles that can guide applicants and patentees for now.

We recommend that applicants still try to protect financial and business methods by way of patents. In that regard, and consistent with our

⁵ Chief Judge Rader criticized Judge Lourie for injecting hindsight into his analysis of Alice's system claims, and improperly "[using] what *has become* routine in 2013 to determine what was inherent in the early 1990s."

⁶ Under that scenario, it is not clear that Judge Linn would participate. Judge Linn has taken senior status on the court, and senior status judges typically do not participate in en banc cases, unless they were on the panel issuing the decision under *en banc* review, which was the case with Judge Linn in *CLS Bank*.

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recommendations in the wake of the *Prometheus* decision, we recommend that patent applicants:

1. Use active language and include active steps in the claims that define the nature and application of the method.
2. Include at least one step applying any correlation or mathematical formula or other concept that could be argued to be a natural law, natural phenomenon, mathematical algorithm, or otherwise an abstract idea, in an active step that acts on a physical object rather than just updating information.
3. Avoid "wherein" and "whereby" clauses that may be construed not to require a specific application of a natural law, natural phenomenon, or abstract idea, when such application is critical to patentability.
4. Include in claims more than a generic recitation of computer components, i.e., something more than basic storage, processing and connectivity components. In that regard, consider including claims identifying any application-specific automated or computer-based physical response to calculations, algorithms or mathematical formulas, such as was done in the *Diehr* claims.

5. If the nature of the invention is likely to raise §101 concerns, e.g., a business method implemented by the generic use of a computer, we recommend focusing the claim budget on system claims of varying scope, rather than computer-readable medium ("*Beauregard*") claims. When possible, however, *Beauregard* claims should still be included to provide claim protection directly covering distribution of software for implementing the invention.

* * * * *

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MEMORANDUM

DATE: May 13, 2013
TO: Patent Examining Corps
FROM: Andrew H. Hirshfeld
 Deputy Commissioner
 For Patent Examination Policy
SUBJECT: Federal Circuit Decision in *CLS Bank et al. v. Alice Corp.*

On May 10, 2013, the Federal Circuit issued the highly anticipated decision in *CLS Bank* involving subject matter eligibility of computer-implemented inventions under 35 U.S.C. § 101. The purpose of this memorandum is to notify the Patent Examining Corps that, at present, there is **no change** in examination procedure for evaluating subject matter eligibility. Current procedure detailed in MPEP 2106 should continue to be followed.

CLS Bank Decision

The patents in suit relate to a computerized trading platform used for conducting financial transactions in which a third party settles obligations between a first and a second party so as to eliminate “counterparty” or “settlement” risk. The district court found all of the claims invalid because they were directed to an ineligible abstract idea under 35 U.S.C. § 101. The Federal Circuit heard the case *en banc* and affirmed the district court in a divided decision.

Along with the decision, the Federal Circuit also issued six separate opinions by various members of the court concurring, dissenting, and offering reflections on the decision. Despite the Court’s sharp divide voiced in the six separate opinions, several important themes emerged, such as:

- There was agreement that the test for eligibility is not a rigid, bright line test and must be made by evaluating a claim as a whole, on a case-by-case basis, using a flexible approach.
- Many of the judges explicitly noted that the test for eligibility is a separate and distinct inquiry from other patentability concerns, particularly novelty and obviousness.
- It was generally agreed that when evaluating the claim as a whole the claim must be analyzed to determine whether the additional limitations add significantly more, or in other words add meaningful limits, to the abstract idea or law of nature.

Given the multiple divergent opinions, the USPTO is continuing to study the decision in *CLS Bank* and will consider whether further detailed guidance is needed on patent subject matter eligibility under 35 U.S.C. § 101.