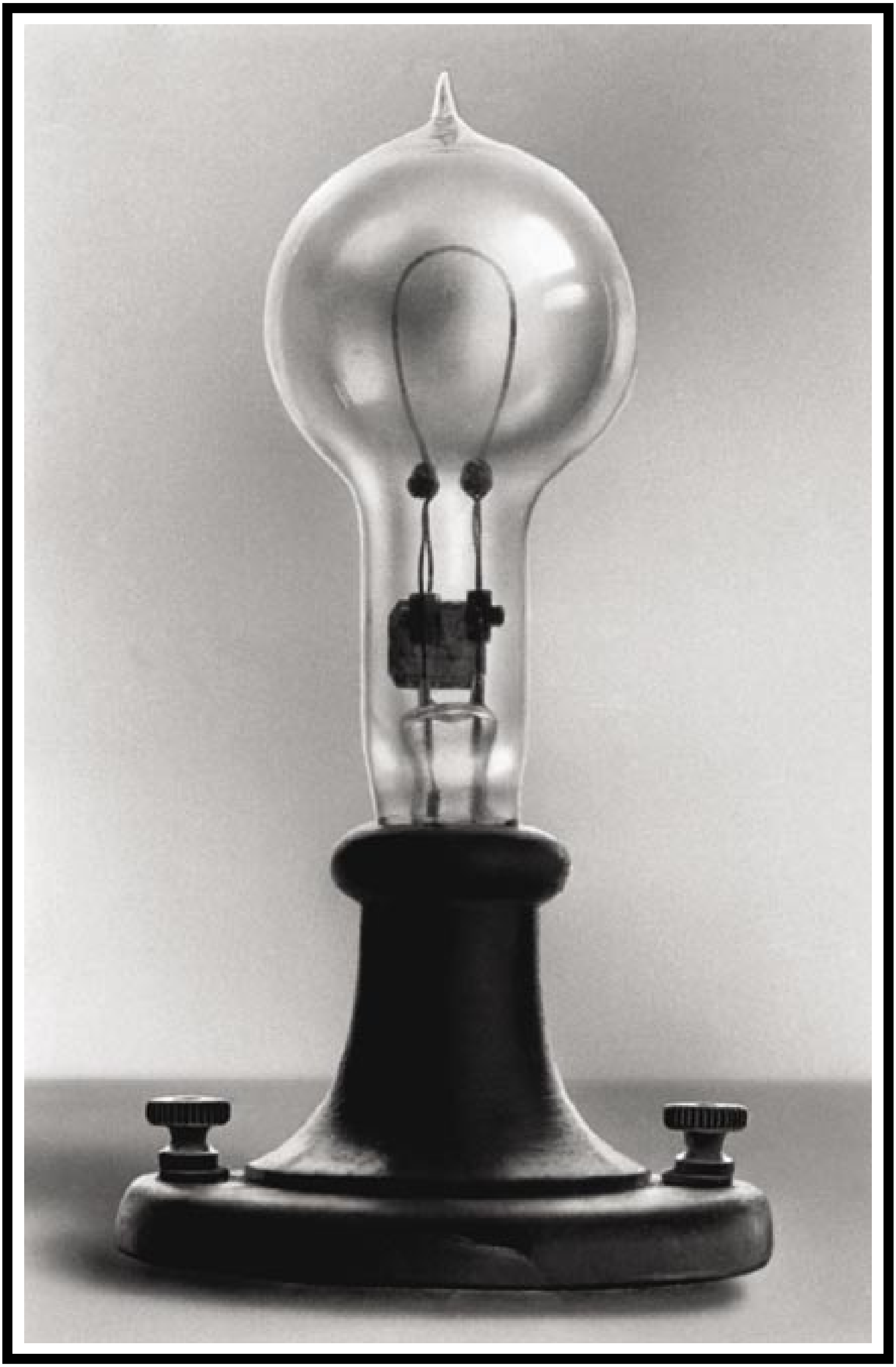

PATENT PENDING

AS ESTATE PLANNING HEATS UP, IT MAY NOT BE ENOUGH TO INVENT A BRILLIANT TAX-SAVING TECHNIQUE FOR YOUR CLIENTS. YOU MAY NEED TO PATENT IT, TOO. BY DEBORAH L. JACOBS

Photography by Bettman/Corbis

WHEN AN ELITE GROUP OF SOME 200 TRUSTS AND ESTATES lawyers gathered in Pittsburgh last October, the main item on their agenda was a sharp digression from the usual fare. Instead of debating the merits of various tools for tax-free transfer of wealth to the next generation, they were getting a crash course in patent law. Their invited guest was Robert Lindefjeld, an intellectual property lawyer with the local office of Jones Day, who spent about 45 minutes lecturing and fielding questions from members of the Estate and Gift Tax Committee of the American College of Trust and Estate Counsel (ACTEC).

The impetus for the meeting, says Dennis Belcher, a lawyer with McGuireWoods in Richmond, Va., who heads the panel, was news that an estate planner for high-net-worth clients had received a patent in 2003 for something colleagues had assumed wasn't patentable. Robert Slane, president of The Wealth Transfer Group in Altamonte Springs, Fla., obtained Patent No. 6,567,790 for what he calls a SOGRAT—a grantor retained annuity trust funded with stock options. That "hit right in our wheelhouse," says Belcher, who, like other ACTEC members, says he has used similar techniques in his practice for years.

Maybe or maybe not. "The patent office has said it hasn't been done before, and there's a presumption that it's right about that," says Matthew Witsil, a lawyer with Moore & Van Allen in Research Triangle Park, N.C., who represents Slane. Mark Nowotarski, a patent strategy consultant specializing in the insurance industry and president of Markets, Patents & Alliances in Stamford, Conn., says that a common misconception among people unfamiliar with the patent process is that they can easily read the patent and figure out whether something has been done before. In fact, interpreting a patent is itself an art, he says. Financial professionals in all fields need to become familiar with intellectual property—the bundle of rights that go with products, services, information, and even certain business names, Nowotarski says.

The key laws that advisers need to know about are federal statutes covering copyrights, patents, and trademarks. Copyright law deals with the expression of an idea, such as software or written materials. Trademarks apply to words, phrases, symbols, or devices or combinations of them that identify your goods or services and distinguish them from those of others—like the name SOGRAT, which Slane has trademarked so that no one else could use it. "I wanted to protect what I thought was my intellectual property," he says. "I didn't want someone else to profit from it."

Patents are granted for inventions that are new, useful, and not obvious to a person "of ordinary skill in the art." That means someone in your field who had to solve the same problem would not be able to come up with your invention merely by reading what's out there, says Nowotarski. A patent gives you the exclusive right to use a particular method—and also to stop others from doing the same—for an extended period, usually 20 years from the date of filing a patent application.

Intellectual property can be important in two respects. When something is your intellectual property, you generally have the right to use it yourself, sell it or license others to use it, and block people from exploiting it without your permission. On the flip side, you must also avoid infringement of other people's work. Steven Oshins, a lawyer with Oshins & Associates in Las Vegas, says he was surprised that Slane got a patent for the SOGRAT, but has engaged Slane's services on behalf of his own clients for this specific technique. So have at least 14 large law firms, according to Oshins. Slane declined to name his clients.

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One audience member at the ACTEC meeting said that Slane had confronted a large financial institution for pitching a comparable product to its clients, Belcher recalls. ACTEC members report the matter was resolved amicably and without any financial consequences. Slane declined to comment.

Other disagreements might not end as well. Lawsuits for patent infringement are both difficult and expensive to defend, Lindefjeld says. As a matter of law, the patent is presumed to be valid, and it's up to the alleged infringer to prove either that what he's doing doesn't violate it or that the technique was in common use when the patent was issued. If you lose a case and your infringement is found to be intentional, you could be on the hook for triple damages, Lindefjeld notes.

Patents for tax strategies and financial products fall within a special subset known as a business method patent, says Dean Alderucci, chief counsel of Walker Digital Management, a Stamford, Conn., think tank that develops and protects proprietary business models and strategies. Unlike a patent for a widget, for example, business method patents describe a series of steps or a process for a service or a way of doing business. Examples include a method of structuring a mutual fund, calculating costs allocated to it, or computing dividends it has accrued.

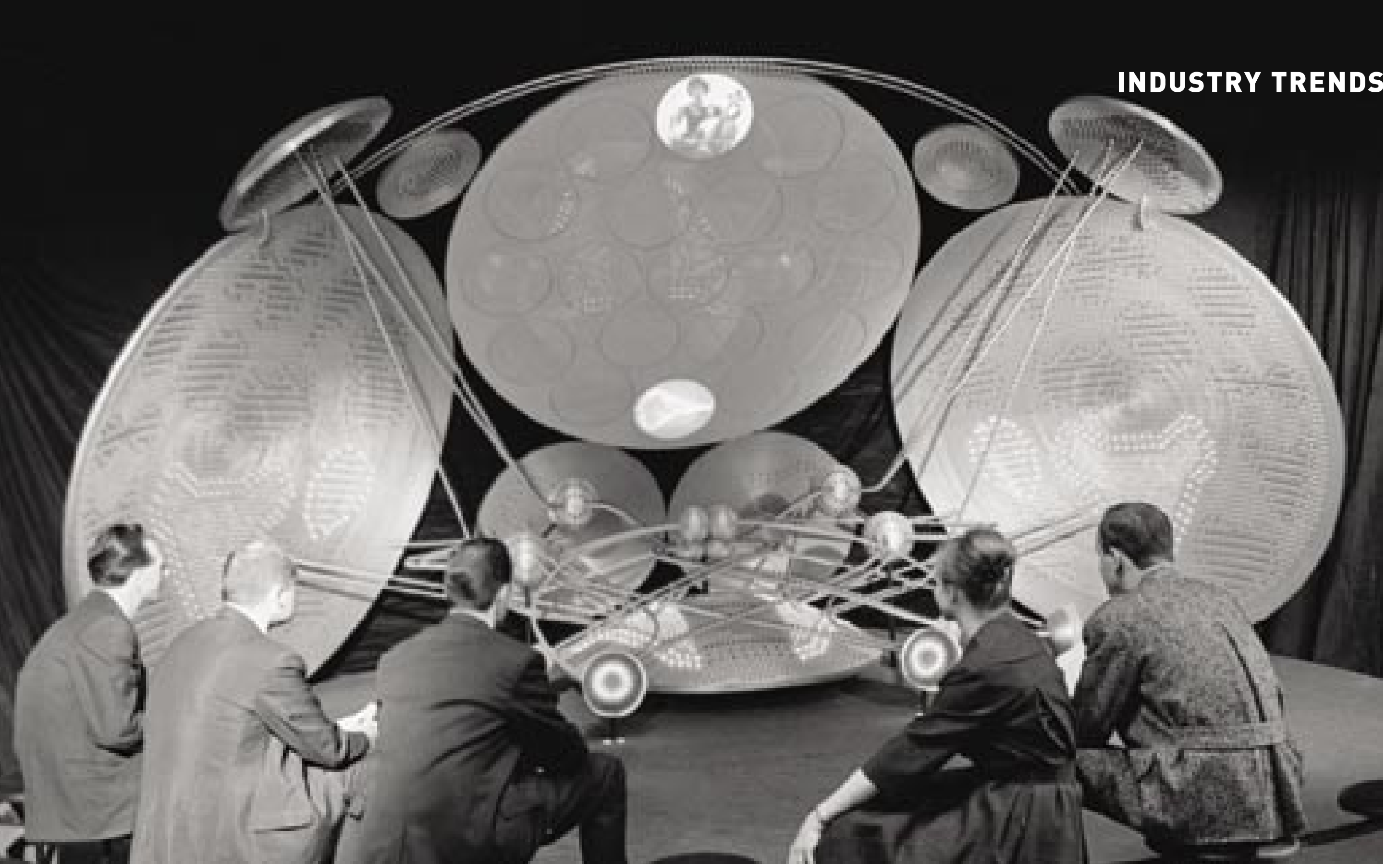
UNTIL FAIRLY RECENTLY, MOST people assumed that financially oriented business methods were not patentable. A turning point was reached with a 1998 decision by the U.S. Court of Appeals for the Federal Circuit that they are. The case involved the "Hub and Spoke" system that Signature Financial Group developed for use in its business of pooling mutual fund assets in an investment portfolio organized as a partnership. This system, which Signature patented, helped monitor and record data for these portfolios in a very cost-efficient way. State Street Bank had tried to get a license to use the system, but when negotiations fell apart, the firm sued Signature, charging that the patent was invalid. The Federal Circuit, reversing a decision of a Massachusetts District Court, sided with Signature. In the process, it opened the door for other financial institutions to obtain patents on business methods, something that they couldn't do before.

An awareness that tax strategies and financial products can be protected as intellectual property has spread slowly in the business community. Brigid Quinn, a spokesperson for the U.S. Patent and Trademark Office, estimates that out of a total of 355,000 patent applications her office received in 2003, fewer than 50 involved tax strategies and financial products.

But Alderucci says that during the past five years he has received an increased number of inquiries about business method patents. And he expects that during the next decade more professionals who develop financial services and tax-saving techniques will perceive the competitive advantages that stem from them. "There's an entire industry that was indifferent to patents 10 years ago and now is making a concerted effort to get up to speed," Alderucci says.

The potential economic advantages include licensing fees and marketing pizzazz. Slane, for example, says that his primary purpose for seeking a patent was to prevent others from stealing his idea. But even being able to say his product had a "patent pending" during the three years that it took to get the patent, "didn't hurt" his efforts to attract clients.

Photography by Roger Ressmeyer/Corbis



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To the uninitiated, patents might seem exploitative and a burden on trade, but Lindefjeld says that the policy behind the patent law is to encourage inventors to make their creations available to the public. Before the system was put in place, people would keep things secret to maximize their competitive advantage, he explains. With financial services, in particular, advisers and their clients were often asked to sign a confidentiality agreement as a condition of learning the specifics of a particular strategy (see "When Mum's the Word," December 2001/January 2002).

Some people speculate that a recent crackdown by the Internal Revenue Service on tax shelters, which has discouraged confidentiality agreements, has also fueled an interest in patenting tax avoidance measures. Under Treasury regulations enacted in December 2003, confidential transactions must be reported to the IRS when a client pays an adviser a large fee—at least $50,000 for individuals and $250,000 for corporations—and the limits on disclosure are designed to protect the confidentiality of the adviser's own tax strategies. This type of transaction is widely presumed to be a red flag for IRS auditors. Jonathan Blattmachr, a lawyer with Milbank, Tweed, Hadley & McCloy in New York, who has publicly expressed concern about the regulations, filed six patent applications between January and April 2002, covering various insurance-related tax-saving techniques. Blattmachr did not respond to requests for comment.

Other professionals on the cutting edge have also beaten a path to the patent office. Howard Winklevoss, a Greenwich, Conn., consultant, in May 2003 applied for patent protection for the so-called donor-managed investment account—basically a new twist on a donor-advised fund. In 2003, Lawrence Bell, an insurance specialist in Bethesda, Md., got Patent No. 6,609,111 for a tax-saving method involving deferred-compensation plans. Winklevoss did not respond to requests for comment. Bell says his patent is "not in use" due to changes in the tax law and the decline in the value of stock options, which have made his strategy no longer "an effective economic tool."

The cost of getting a patent runs between $10,000 and $20,000, including legal expenses and filing fees, and can take three to five years, lawyers say. In the business method area, computer-implemented processes are likely to get a quicker review and stand a greater likelihood of success, Alderucci says. While they wait to get a patent, inventors can label their

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materials with the phrase “patent pending,” which might discourage others from ripping off the product.

Once patents are issued, they’re a matter of public record, available on the U.S. Patent Office Website, www.uspto.gov. Applications are also posted on the Website within 18 months of the time they are filed unless inventors ask that they be kept private. These requests are routinely granted, Witsil says, but you don’t have the option of keeping the application private if you plan to file for a patent in a foreign country.

Although inventors may be concerned about tipping their hand while the patent is pending, there’s a strategic advantage to getting the application published, Witsil says. Only if it’s published can your damages from an alleged infringer include the time that the patent was pending. To receive these damages, you must give notice to the infringer after the application is published, but you can’t collect anything until the patent is actually issued, he says.

Having gone through the effort and expense of getting a patent, inventors must also be prepared to devote some resources to enforcing it. And to some extent, infringement may be difficult to detect. For example, innocent infringement of the SOGRAT, done in the privacy of a lawyer’s office, might never come to light, says Carolyn Ohlsen, a lawyer with Lowenhaupt & Chasnoff in St. Louis.

Slane says he’s not concerned about individuals who inadvertently infringe his patent, but about tax planning, accounting, and law firms that intentionally violate it repeatedly. To help him detect such infractions, he enlists the help of a service, SECinfo.com, which for a nominal

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quarterly fee tracks public disclosures that corporate insiders are required to make to the Securities and Exchange Commission when they transfer options. So far, Slane says, he has not turned up any potential patent violations that way.

People who don't want to go through the effort and expense of getting a patent might try to protect their intellectual property with a copyright, trademark, or service mark. For example, Oshins got a trademark in May 2004 for something called The Inheritor's Trust—an approach that allows younger generation members to design the form in which they will receive their inheritance (outright or in trust) and amends senior family members' estate plans to reflect those wishes.

Michael Weinberg, a financial planner with The Weinberg Group in Denver, says he copyrights all his materials to discourage people from pirating them. He has trademarked an intentionally defective grantor trust that he calls the "IDIOT trust," which stands for "Intentionally Defective Irrevocable Outstanding Trust." From a marketing perspective, displaying a copyright or trademark notice on his materials "makes it look like something special and not a commodity," Weinberg says.

But Alderucci emphasizes that the protection such actions offer is "weaker" than a patent. Copyrighting a trust document, for example, "might impede a blatant copyist" from lifting blocks of text, but it wouldn't stop him from structuring the trust the same way as you have, he says. A trademark, which is always complementary to a patent, covers the name or logo you give to it but unlike a patent doesn't protect the product itself.

One question that arises is whether patent examiners have the expertise to review the sort of sophisticated tax strategies and financial products that are coming over the transom. Quinn, of the U.S. Patent and Trademark Office, says that her office has developed partnerships with associations of bankers, insurers, and financial institutions to learn about "the state of the art." The office has a long tradition of evaluating the unfamiliar, she adds. "We've been dealing with emerging technologies for 200-plus years."

What steps can professionals like ACTEC members take if they think a patent has been issued, or might be issued, for something that's been done before? While an application is pending, their options are limited, Alderucci says. The best they can do is to file an affidavit with the patent office documenting prior use of a technique, such as a law review article published before the patent application.

Once the patent has been issued, they have a few more alternatives. With the help of a patent lawyer, they can identify minor loopholes in the patent and make changes in their own product or service to avoid infringement. Another possibility, says Quinn, is to submit evidence that the business method isn't new—again, a journal article describing it would suffice—and ask the Patent Office to reexamine the patent they're concerned about. This process, which costs $2,800, could result in the patent holder losing the patent, Quinn says. Although her office gets fewer than 400 such requests per year, the success rate is high, she says. Requests for reexamination are granted 90 percent of the time and in 70 percent of these cases either the patent is narrowed or the person holding it loses the patent altogether.

Other legal recourse requires that you be threatened by the patent holder—for instance, if you or your client receive a letter demanding licensing payments, Alderucci says. At that point, you can sue the patent holder to invalidate the patent. If you're sued yourself, one defense is that the patent is invalid, Lindefjeld says. Another is that the claims don't cover exactly what you're doing. The American Inventors Protection Act of 1999 also contains a bulletproof defense for people who had been practicing a business method before someone else got a patent on it, says Lindefjeld. There's no infringement if you can show that, acting in good faith more than a year before the person filed a patent application, you were using the same business method in your own work (35 U.S. Code Section 273).

APART FROM THE LEGAL ISSUES IS the question of what these trends will do to otherwise amicable relationships among professionals who in the past would have shared their ideas publicly on listservs, at professional conferences, and elsewhere. William Weinsheimer, a lawyer with Foley & Lardner in Chicago who heads the ACTEC Practice Committee, says the group is looking into whether the organization should officially approve or disapprove of its members patenting tax-saving techniques. In his own view, Weinsheimer says, "most estate planners would feel that [such patents are] kind of antithetical to the way we practice."

Nowotarski, who predicts an end to the kind of "free sharing" that many ACTEC members still expect, recommends that before professionals talk to each other about a new tax strategy, they think about whether it is something they might want to patent. If it is, he says, "file a patent application. Then talk about it."

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