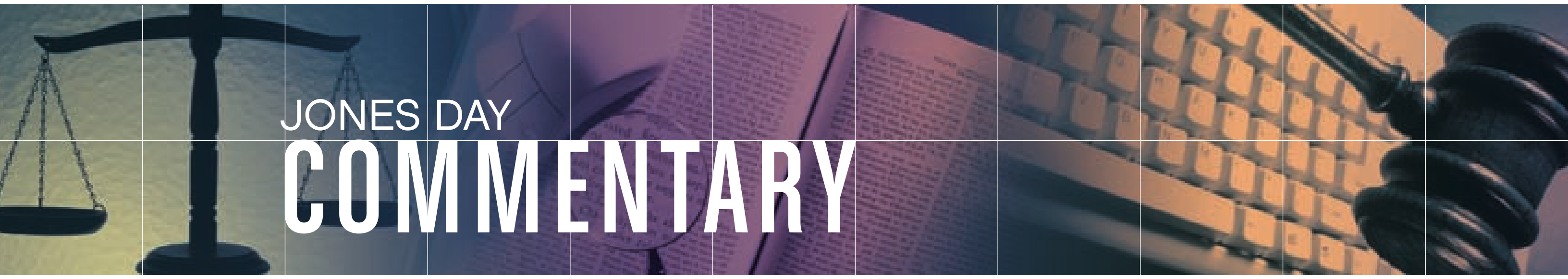

MICROSOFT CORP. V. AT&T CORP.: THE UNITED STATES SUPREME COURT REINS IN THE EXTRATERRITORIAL EFFECTS OF UNITED STATES PATENT LAW

The increasing globalization of commerce has created tension with the United States patent laws, which in general have an effect only within the borders of the United States. As a result, the courts have faced more and more cases where the United States patent laws—in particular, 35 U.S.C. § 271(f), which deals with situations where components are created in the United States and then shipped abroad for combination—are being asserted against acts that take place partially or wholly outside the United States.

In 2005, the United States Court of Appeals for the Federal Circuit handed down a series of cases involving the extraterritorial effects of the U.S. patent laws, including *Eolas v. Microsoft*, *NTP v. Research in Motion*, and *Union Carbide v. Shell Oil.* (See "Recent Federal Circuit Decisions Address Extraterritorial Limits of United States Patent Law," *Jones Day Commentary*, January 2006.) Perhaps the most significant of the Federal Circuit's extraterritorial-application cases in 2005 was its 2-1 decision in *AT&T v. Microsoft.* That decision appeared to open the door for software patentees to extend the reach of their intellectual property to invoke the provisions of 35 U.S.C. § 271(f) to exclude infringing activities that take place outside the United States. The United States Supreme Court took up the issue and, on April 30, 2007, reversed the Federal Circuit's expansive decision. The net effect of that decision will be to rein in the extraterritorial effect of United States patent law to some extent, at least as it applies to patents relating to computer software.

BACKGROUND

In *Deepsouth Packing Co. v. Laitram Corp.* (1972), the Supreme Court held that making or using a patented product outside the United States did not fall within the ambit of the patent law as it existed at that time. That ruling left open the possibility that a potential infringer could make all of the individual components of a product covered by a United States patent in the

United States and ship them offshore to be combined into the final product, without facing any liability for infringement. In response to the *Deepsouth* decision, Congress amended the patent statute in 1984, such that § 271(f) now reads:

> (1) Whoever without authority supplies or causes to be supplied in or from the United States all or a substantial portion of the **components of a patented invention**, where such components are uncombined in whole or in part, in such manner as to actively induce the **combination of such components outside of the United States in a manner that would infringe the patent if such combination occurred within the United States**, shall be liable as an infringer.
>
> (2) Whoever without authority supplies or causes to be supplied in or from the United States **any component of a patented invention** that is especially made or especially adapted for use in the invention and not a staple article or commodity of commerce suitable for substantial noninfringing use, where such component is uncombined in whole or in part, knowing that such component is so made or adapted and intending that such component will be **combined outside of the United States in a manner that would infringe the patent if such combination occurred within the United States**, shall be liable as an infringer.

Under the amended statute, liability for "machine" or "apparatus" patents is a relatively easy question under § 271(f). Under those circumstances, the central questions involve what components are being shipped, what the sole or intended purpose of those components is, and whether the combination infringes the claims. Trickier questions come into play when intangible components, components of processes, or steps of method patents are at issue.

Past Federal Circuit decisions had suggested that only a *physical* component for use in a combination apparatus was a proper subject of § 271(f). However, when faced with the situation presented in *Microsoft*, the Federal Circuit expanded the reach of § 271(f) to hold that an intangible thing, such as software code, could be a "component" under § 271(f). Indeed, the court went further and found that whether software is sent abroad via electronic transmission or shipped abroad on a "golden master" disk is a distinction without a difference for the purposes of § 271(f) liability:

> Were we to hold that Microsoft's supply by exportation of the master versions of the Windows® software—specifically for the purpose of foreign replication—avoids infringement, we would be subverting the remedial nature of § 271(f), permitting a technical avoidance of the statute by ignoring the advances in a field of technology—and its associated industry practices—that developed after the enactment of § 271(f). **It would be unsound to construe a statutory provision** that was originally enacted to encourage advances in technology by closing a loophole, **in a manner that allows the very advances in technology thus encouraged to subvert that intent. Section 271(f), if it is to remain effective, must therefore be interpreted in a manner that is appropriate to the nature of the technology at issue.**

This broad language and reasoning opened the door to expose more foreign activity to liability under § 271(f). The United States Supreme Court's reversal of the Federal Circuit's decision has closed that door and created a safe harbor for United States software manufacturers to distribute potentially infringing software outside the United States.

THE SUPREME COURT REVERSES

In *Microsoft*, the acts demonstrating Microsoft's infringement were not in dispute; the only question was whether certain of those acts legally constituted infringement under United States patent law. Microsoft admitted that its Windows software infringed the AT&T patent, but only when it was installed on a computer. Microsoft further admitted it was liable for inducing infringement when it licensed copies of Windows to United States computer manufacturers for installation on computers in the United States. The only issue presented was whether Microsoft's liability for infringement extended to computers made in other countries when those computers were loaded with Windows software that had been copied outside the United States from a master disk or electronic transmission sent from within the United States. In a 7-1 decision (the Chief Justice took no part in the case) generating three separate opinions, the Supreme Court concluded that Microsoft was not liable for the alleged infringements occurring outside the United States.

In reaching this conclusion, the Court focused on certain fundamental aspects of 35 U.S.C. § 271(f). These aspects included what qualifies as a "component" under § 271(f) and whether such components were supplied from the United States. Figure 1 helps illustrate the focus of the Court.

Having made this distinction, the Court concluded that only software in a tangible medium could qualify as a "component" under § 271(f). "Abstract software code is an idea without physical embodiment, and as such, it does not match § 271(f)'s categorization: 'components' amenable to 'combination.'" Thus, a major point advanced by AT&T and the Federal Circuit, *i.e.*, that software in and of itself could be a component under § 271(f), was struck down by the Court, thereby restricting the reach of § 271(f) liability.

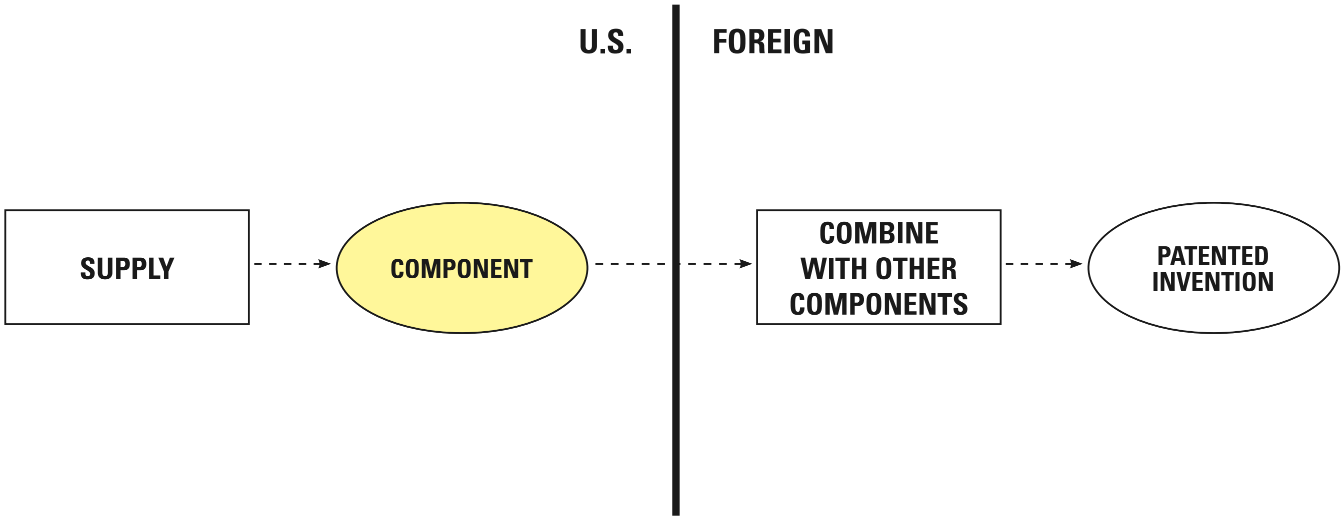

Figure 1

As Figure 1 depicts, a "component" must be supplied from the United States so that it can be combined with other components to form the patented invention—that is, on which side of the line or border a component resides is important. This is the basic framework for which liability is established under either § 271(f)(1) or (f)(2). (There are other factors that need to be established to find liability, but without at least the combination of a component supplied from the United States as shown in the figure, there can be no liability under § 271(f).)

To assess whether the shipping of a master version of software from the United States for use in making copies fits within this basic framework, the Court first wrestled with the issue of when, or in what form, software could qualify as a "component" under 35 U.S.C. § 271(f). The Court drew a distinction between two concepts of software:

> One can speak of software in the abstract: the instructions themselves detached from any medium. (An analogy: The notes of Beethoven's Ninth Symphony.) One can alternatively envision a tangible "copy" of software, the instructions encoded on a medium such as a CD-ROM. (Sheet music for Beethoven's Ninth.)

With respect to the second issue presented, *i.e.*, whether the components were supplied from the United States, the Court further restricted the reach of § 271(f). Because the Court concluded that it is the *copy* from the master version (and not the master version itself) that qualifies as a "component," the only item supplied by Microsoft from the United States was the master version. AT&T argued that because computer disks can be copied easily and inexpensively, the extra step of copying in the foreign country should be disregarded. The Court disagreed: "[T]he extra step is what renders the software a usable, combinable part of the computer; easy or not, the copy-producing step is essential." Because the copying that created the "components" (as that term is used in the statute) took place outside the United States, the Court viewed the facts of this case with respect to the framework of § 271(f) as follows:

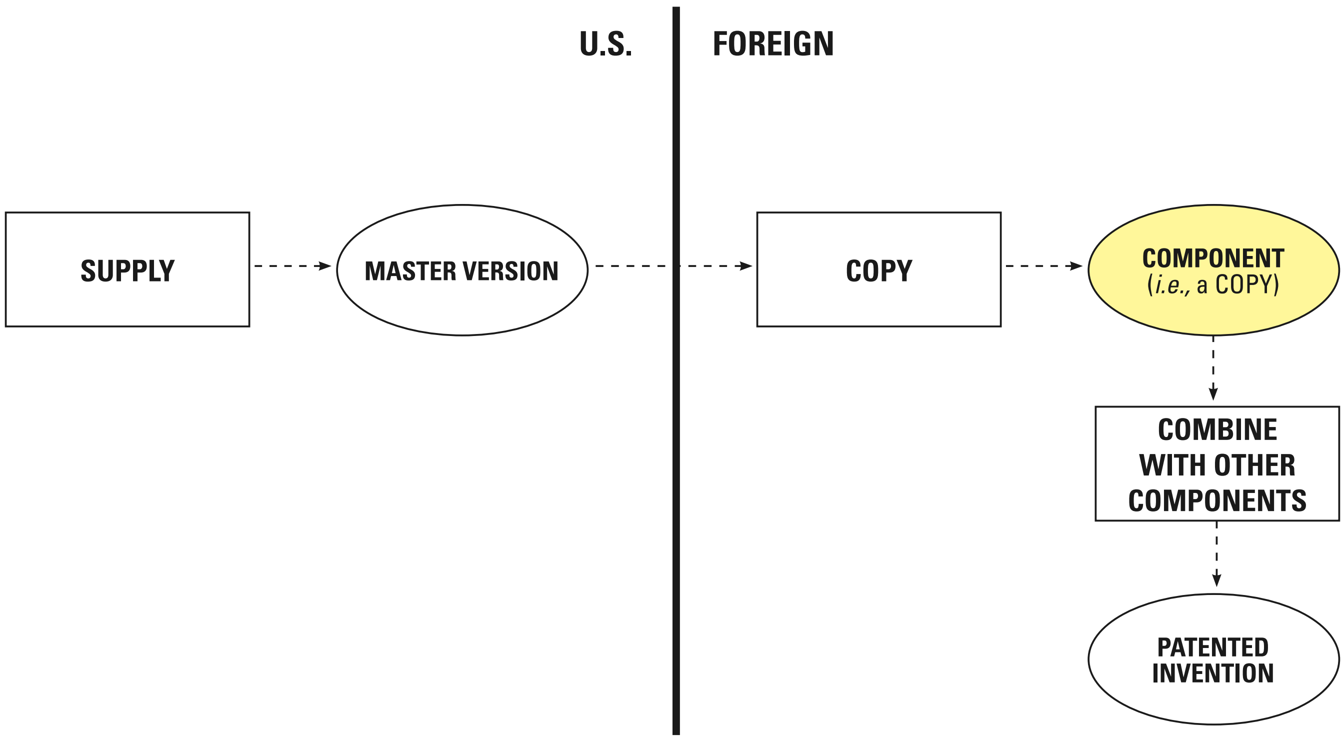

Figure 2

As Figure 2 depicts, a master version is supplied outside the United States from which copies are made. It is the copies (which the Court found to be the "components") that are installed on the computers, thereby creating the patented invention. In contrast to the § 271(f) liability framework of Figure 1, Figure 2 shows a component (in this case, one of the foreign-made copies of Windows) not being supplied from the United States, but rather only coming into existence outside the United States after the foreign-based copying process is performed. By distinguishing the step of copying from the requirement in the statute that the accused infringer must "supply" the accused components, the Court concluded that the copies of Windows (*i.e.*, the components) made overseas had not been *supplied* from the United States as required by the statute and thus Microsoft was not liable under § 271(f). Notably, in this case, the Court was faced with a situation identical to the one it faced in *Deepsouth*: specifically, an issue of first impression in light of advancements in the technology. Just as in *Deepsouth*, the Court took a narrow view of the issue and invited Congress to revisit it and expand the reach of § 271(f) by amendment if it so chooses.

Three justices (Justices Alito, Thomas, and Breyer) concurred in the ultimate conclusion but wrote separately to explain their differing rationale. Justice Alito provided the fifth vote for Justice Ginsburg's majority opinion for the Court and joined all of her opinion except for footnote 14, which chose not to address the issue of whether "a disk shipped from the United States, and used to install Windows directly on a foreign computer, would not give rise to liability under § 271(f) if the disk were removed after installation." The concurring opinion focused on the "combination" requirement of the statute. Because there is no need for the CD-ROM to stay in the computer once the software is copied onto the computer's hard drive, the concurring justices concluded that there was no "component" originating in the United States that was "combined" with the foreign-made computers.

> Accordingly, it is irrelevant that the Windows software was not copied onto the foreign-made computers *directly* from the master disk or from an electronic transmission that originated in the United States. To be sure, if these computers could not run Windows without inserting and keeping a CD-ROM in the appropriate drive, then the CD-ROMs might be components of the computer. But that is not the case here.
>
> * * *

> Because the physical incarnation of the code on the Windows CD-ROM supplied from the United States is not a "component" of an infringing device under § 271(f), it logically follows that a copy of such a CD-ROM also is not a component.

Justice Stevens dissented. In his view, even though software is analogous to an abstract set of instructions, he would nonetheless characterize it as a "component" within the meaning of § 271(f), as did the Federal Circuit majority.

The Court's opinion concluded with two relatively bright lines to help define the boundaries of liability under § 271(f). First, the Court held: "[F]oreign law alone, not United States law, currently governs the manufacture and sale of components of patented inventions in foreign countries." The Court advised patentees desiring to prevent copying in foreign countries to obtain and enforce foreign patents, and not to rely upon § 271(f). Second, the Court specifically excluded certain "design tools" from the reach of § 271(f): "There is no dispute, we note again, that § 271(f) is inapplicable to the export of design tools—blueprints, schematics, templates, and prototypes—all of which may provide the information required to construct and combine overseas the components of inventions patented under United States law."

Still, even with these express pronouncements, the way remains somewhat unclear for both patent holders and accused infringers as advances in technology continue to raise new questions and blur both geographical and intellectual property boundaries.

OBSERVATIONS

Perhaps the most immediate effect of the *Microsoft* decision is the curtailment of potential infringement risk for software companies. Under the Federal Circuit's view, a patentee could preclude—and collect damages for—conduct occurring outside the United States. The Supreme Court's reversal has both cut off infringement liability for such conduct and painted a road map (as illustrated in Figure 2) for software companies to avoid infringement liability for certain acts occurring offshore. As evidence of this case's immediate effect, Microsoft's general counsel remarked in *The Wall Street Journal* that "Simply by winning this decision today, we reduce the liability exposure in [other patent lawsuits filed against Microsoft] by something close to 60%."

For patentees, this decision also raises a number of issues that must be considered in creating an effective prosecution strategy for protecting their valuable ideas. Patentees must rely more on obtaining and enforcing foreign patents that are counterparts to their United States patents. This is a costly investment, but necessary now if a patentee is to collect damages for, or otherwise halt, this type of activity occurring abroad.

Furthermore, what does this decision indicate about the Supreme Court's view of the extraterritorial reach of the United States patent laws? In the majority opinion, Justice Ginsburg relied upon "the presumption that United States law governs domestically but does not rule the world," saying that the presumption "applies with particular force in patent law." This suggests that the Court is generally reluctant to read the patent statutes, without guidance from Congress, in a way that would allow the expansion of the reach of United States law beyond the United States borders. Any change in the laws' effect on actions abroad is going to have to come from Congress, just as § 271(f) was added by Congress in response to the *Deepsouth* case.

In addition, the Supreme Court's decision to settle on particular analogies, and to reject others, with respect to defining the nature of computer software could have effects on other cases not involving issues of extraterritorial effect. For example, the Federal Circuit is currently considering a case involving the question of whether a data-encoded signal or transmission, and the information it is carrying, can qualify as proper patentable subject matter under 35 U.S.C. § 101 (as an "article of manufacture"), or whether it is more akin to an unpatentable abstract idea or natural phenomenon. *See In re Nuijten*, No. 06-1371.

The *Microsoft* decision (along with the Supreme Court's decision in *KSR Int'l Co. v. Teleflex Inc.* issued on the same day) continues the trend of reversals in this era of unprecedented Supreme Court interest in patent issues. Indeed, from 2002 to date, the Supreme Court has granted *certiorari* 11 times in patent cases, decided nine of them (two were dismissed), and did not affirm the Federal Circuit even once. These two most recent decisions seem to further signal the Supreme Court's intention to continue its closer supervision of the Federal Circuit's patent decisions—a new attitude when compared to the Court's largely hands-off treatment of the Federal Circuit in its earlier days—to ensure that the United States patent laws are given appropriate scope and, in this instance, appropriately limited extraterritorial reach.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

John V. Biernacki
1.216.586.7747
jvbiernacki@jonesday.com

Susan M. Gerber
1.216.586.7153
smgerber@jonesday.com

Gregory A. Castanias
1.202.879.3639
gcastanias@jonesday.com