

ASPEN PUBLISHERS

MARCH/APRIL 2008
VOLUME 14 NUMBER 2

DEVOTED TO
INTELLECTUAL
PROPERTY
LITIGATION &
ENFORCEMENT

*Edited by the Law Firm of
Grimes & Battersby*

Litigator



Wolters Kluwer
Law & Business

Microsoft Corp. v. AT&T Corp.: The US Supreme Court Reins in the Extraterritorial Effects of US Patent Law

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The increasing globalization of commerce has created tension with the US 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 in which the US patent laws—in particular, 35 U.S.C. § 271(f), which deals with components that 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 US Court of Appeals for the Federal Circuit handed down a series of cases involving the extraterritorial effects of the US patent laws, including *Eolas v. Microsoft*,¹ *NTP v. Research in Motion*,² and *Union Carbide v. Shell Oil*.³ Perhaps the most significant of the Federal Circuit's extraterritorial-application cases in 2005 was its 2 to 1 decision in *AT&T v. Microsoft*.⁴ The *AT&T* 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 US 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 US patent law to some extent, at least as it applies to patents relating to computer software.

Background

In *Deepsouth Packing Co. v. Laitram Corp.*,⁵ 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 US 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 Section 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

Section 271(f). Under those circumstances, the central questions generally 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 Section 271(f). For example, in *Pellegrini v. Analog Devices, Inc.*,⁶ the Federal Circuit held that there is no violation of 35 U.S.C. § 271(f) when a US party provides instructions to offshore locations for the production and disposition of integrated circuit chips. The Federal Circuit held in that case that Section 271(f) “applies only where components of a patented invention are physically present in the United States and then either sold or exported . . .”. Indeed, the Court went further and explicitly stated that “there can be no liability under 271(f)(1) unless components are shipped from the United States for assembly.” A similar result was reached in an earlier case, *Standard Havens Products, Inc. v. Gencor Industries, Inc.*,⁷ in which a foreign sale of an unpatented apparatus was found not to infringe a method patent.

However, the Federal Circuit’s quartet of 2005 decisions—*Eolas v. Microsoft*, *NTP v. Research in Motion*, *Union Carbide v. Shell Oil*, and *AT&T v. Microsoft*—departed from that line of authority, suggesting that Section 271(f) would be applied to intangible components. And, while conventional understanding had previously held that method claims as a class were probably excluded from the reach of Section 271(f), the Federal Circuit’s decision in *Union Carbide* appeared to put that view to rest.

In *Union Carbide*, Shell supplied a catalyst abroad that was used in a process that allegedly infringed Union Carbide’s patent. In reaching its conclusion that that liability under Section 271(f) could attach for the supply of components of a process claim, the Federal Circuit relied on the language of *Eolas* to reiterate that “every component of every form of invention deserves the protection of 35 U.S.C. § 271(f).” Supported by *Eolas* and its own decision in *Microsoft*, the Federal Circuit explicitly swept method claims within the reach of Section 271(f): “In brief, because § 271(f) governs method/process inventions, Shell’s exportation of catalysts may result in liability under § 271(f).” Interestingly, Union Carbide sought a rehearing of this decision *en banc*. The request was denied. However, four judges—Lourie, Michel, Linn, and Dyk—dissented from the denial. Judge Lourie wrote that he, joined by Judges Michel and Linn, believed the panel’s decision to extend Section 271(f) to method/process inventions was contrary to the statutory scheme and recent case law.⁸

In its review of the AT&T/Microsoft dispute, the Federal Circuit further addressed the extraterritorial reach of Section 271(f) as it applied to an intangible thing, such as software code. There, too, the Federal Circuit held that software code could be a “component” under Section 271(f). Indeed, there, 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 Section 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.**

It appears that this broad language and reasoning will open the door to expose more foreign activity to liability under Section 271(f). The US Supreme Court’s reversal of the Federal Circuit’s decision has closed that door and apparently created a safe harbor for US software manufacturers to distribute potentially infringing software outside the United States. Moreover, as the Supreme Court’s reversal of the Federal Circuit’s decision in *Microsoft* has eroded part of the foundation underlying the *Union Carbide* decision, coupled with the fact that four Federal Circuit judges voted to rehear the *Union Carbide* case *en banc*, the question of whether Section 271(f) also governs method/process inventions may now also have been reopened.

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 US 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 US 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 to 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 Section 271(f) and whether such components were supplied from the United States. Exhibit 1 helps illustrate the focus of the Court.

As Exhibit 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 Section 271(f)(1) or Section 271(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 exhibit, there can be no liability under Section 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.

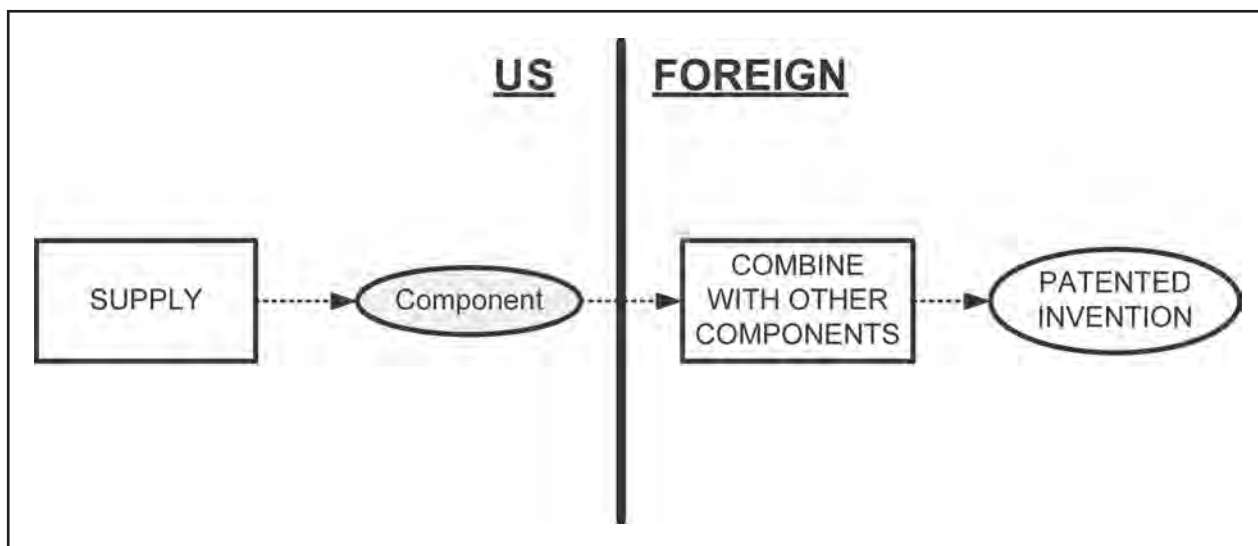
§ 271(f). The Court drew a distinction between two concepts of software:

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.)

Having made this distinction, the Court concluded that only software in a tangible medium could qualify as a "component" under Section 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 Section 271(f), was struck down by the Court, thereby restricting the reach of Section 271(f) liability.

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 Section 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,

Exhibit 1



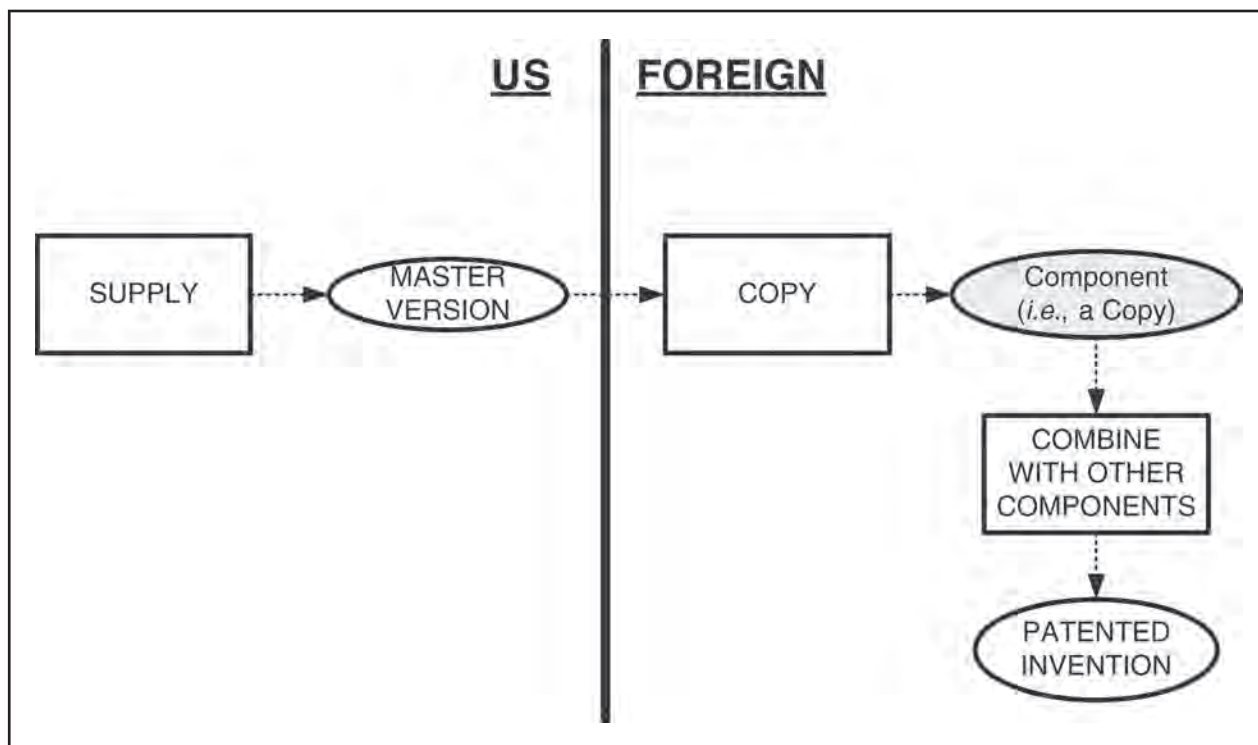
the copy-producing step is essential.” Because the copying that created the “components” (as that term is used in the statute) took place outside the United States, the Court viewed the facts of this case with respect to the framework of Section 271(f) as shown in Exhibit 2.

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 Section 271(f) liability framework of Exhibit 1, Exhibit 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 Section 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 Section 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 Section 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.

Exhibit 2



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 Section 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 Section 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 on Section 271(f). Second, the Court specifically excluded certain “design tools” from the reach of Section 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 apparently cut off infringement liability for such conduct and painted a road map (as illustrated in Exhibit 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%.”⁹

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 should focus more on obtaining and enforcing foreign patents that are counterparts to their US patents.

This is a costly investment, but seemingly 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 US patent laws? In the majority opinion, Justice Ginsburg relied on “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 US law beyond US borders. Any further change in the laws’ effect on actions abroad is going to have to come from Congress, just as Section 271(f) was added by Congress in response to the *Deepsouth* case.

But what is the likelihood that Congress will act on this issue in the near future? The currently-pending Patent Reform Act of 2007 (PRA 2007),¹⁰ addresses many areas of the patent law, including awarding patents to the first-to-file, assignee filing, prior user rights, patent damages, enhanced patent reexamination, post-grant review proceedings, publications of applications after 18 months, submission of prior art by third parties, venue for patent suits, interlocutory appeals of claim construction, and expanded US Patent and Trademark Office rulemaking authority. The bill, while comprehensive, does not presently include legislation to address the extraterritorial reach of US patents. Although the PRA has been significantly amended as issues are debated, amending Section 271(f) in the current legislation this session might be discouraged for at least a couple of reasons. First, there appears to be a perception among lawmakers that the issue has been resolved by the Supreme Court, and, therefore, Congress does not need to address the issue. If Congress takes this approach, it would not be the first time that an issue was dropped in response to a decision from the Supreme Court. For example, the early versions of PRA 2007 included legislation to govern the awarding of injunctive relief to patentees. After the Supreme Court’s decision in *eBay v. MercExchange* was handed down, that portion of the proposed legislation was removed from the pending bill. Second, injecting the issue into PRA 2007 would add potential controversy to the bill. The controversial nature of the issue is evident from the fact that at least 16 *amici* filed briefs before the Supreme Court in the *Microsoft* case. Presumably, the bill’s supporters will want to keep the controversial provisions of PRA 2007 to a minimum to improve the chances that it will pass. Third, while attempts have been made in the recent past to reform the patent laws, they have met with little success. Progress on PRA 2007, however, has been moving forward and the subcommittees on intellectual property may be reluctant to complicate the

process by adding issues that will create further need for debate and that might translate into delay. Whether the legislature will attempt to amend Section 271(f) this term is currently unknown. Certainly, pressures from all sides will dictate the outcome.

In the meantime, the effect of the Supreme Court's decision will percolate through the lower courts and the Federal Circuit. The ripple effect of the Supreme Court's decision is being seen in post-*Microsoft* decisions coming out of the district courts. For example, in *Semiconductor Energy Laboratory Company Ltd. v. Chi Mei Optoelectronics Corp.*,¹¹ the district court considered the proper construction of the direct infringement statute, 35 U.S.C. § 271(a), to determine if it would reach sales activity outside the United States. Specifically, the district court considered whether an offer for sale made in the United States could constitute direct infringement if the accused product is ultimately sold outside of the United States. The parties cited two opposing lines of district court authority, each in support of their respective positions. One line of cases held that as long as an offer was made in the United States, the geographic location and physical destination of the goods were immaterial to the analysis. Taking the exact opposite view, the other line of cases held that because the contemplated sales were intended to occur outside the United States and did, in fact, occur outside the United States, liability under Section 271(a) did not attach. The district court declined to rely on either line of cases and, instead, looked to the Supreme Court's decision in *Microsoft*. Quoting the Supreme Court's comments in *Microsoft*—"[t]he presumption that United States law governs domestically but does not rule the world applies with particular force in patent law," and "[t]he traditional understanding that our patent law operates only domestically and does not extend to foreign activities"—the district court declined to construe Section 271(a) to extend its reach to encompass foreign activities and concluded that domestic offers for sale do *not* constitute direct infringement when the sale occurs outside the United States.

Another district court decision applying the Supreme Court's decision is *Informatica Corp. v. Business Objects Data Integration, Inc.*¹² The district court there was confronted with applying the Supreme Court's decision to four different software distribution methods that were used to provide software outside the United States. The four different software distribution methods were:

1. Shipping a master CD from San Jose, California to outside the United States;
2. Shipping the product directly from San Jose to outside the United States;
3. Downloading the product through a third party; and

4. Downloading the product directly from the defendant.

With respect to the first distribution method, the court followed the Supreme Court's decision and refused to find liability for shipping the master CD abroad. With respect to the second distribution method, the court *did* find liability when software was duplicated and the duplicates themselves were shipped outside the United States for use by the customers. Because the Supreme Court's decision was less clear as to the third and fourth distribution methods, the court decided to address that issue more fully in the context of defendant's forthcoming motion for new trial on damages.

On August 16, 2007, the court issued a decision on defendant's motion.¹³ In the decision, the court did not elaborate on whether liability would exist with respect to the third and fourth distribution methods. Rather, the court stated:

[W]ithout evidence at trial of the amount of foreign sales attributable to each of the four different methods by which defendant provides its software to foreign customers, some of which are actionable under § 271(f) and some of which no longer are after *Microsoft*, the Court cannot reach a reasoned decision on any amount of foreign sales for remittitur.

Accordingly, the court did not decide the issue of whether a user downloading a software product from a third party or from the defendant itself would fall within Section 271(f). However, it is instructive in indicating that a plaintiff might be well advised to focus some of its efforts in discovery to establish the breakdown for each foreign distribution method of the infringing product when the plaintiff is pursuing damages under Section 271(f).

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, software code that is divorced from a physical embodiment was found to be "abstract" and constitute an "idea." Does such a categorization sound a death knell for proponents of continuously expanding the scope of patentable subject matter for software? The terms "abstract" and "idea" could suggest that software code might be classified more like one of the prohibited areas for patentable subject matter, namely, that one cannot patent an abstract idea. Consistent with the Court's recent decisions drawing parallels between patent law and copyright law,¹⁴ the Court's use of these terms appears to echo the copyright-law distinction between ideas themselves (which are not

copyrightable) and expressions of those ideas (which are copyrightable).¹⁵

With use of these specific terms in its decision, a question arises: Is the Supreme Court tacitly signaling a possible curtailment of what forms of software inventions can constitute patentable subject matter under 35 U.S.C. § 101?

As an illustration, the Federal Circuit recently decided 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 Section 101, or whether it is more akin to an unpatentable abstract idea or natural phenomenon.¹⁶ The case decided that these signals, which the PTO did not dispute are demonstrably new and nonobvious, nonetheless cannot be patented under Section 101 of the Patent Act, because such physical but transitory forms of signal transformation do not fall within any of the four statutory categories—process, machine, manufacture, or composition of matter—set forth in Section 101.¹⁷

Finally, a plaintiff is not wholly bereft of pursuing damages related to shipping of a master CD abroad by a defendant. A plaintiff may have in its arsenal of claims a “computer-readable medium” type of claim. In such a claim, the computer-readable medium itself is the subject

of the claim and further contains software instructions for performing an inventive method. The computer-readable medium claim would more directly cover what is being exported and thus more likely to be found infringed by the shipping of the master CD abroad. Another, perhaps obvious, solution suggests that US patentees should pursue patent protection in foreign countries rather than attempting to rely on the extraterritorial reach of patent protection from the United States.

The *Microsoft* decision (along with the Supreme Court’s decision in *KSR Int’l Co. v. Teleflex Inc.*,¹⁸ 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. It now appears increasingly likely that if Congress does not act to “reform” the patent laws, the Supreme Court appears ready to do so, on a case-by-case basis.

1. *Eolas v. Microsoft*, 399 F.3d 1325 (Fed. Cir. 2005).
2. *NTP v. Research in Motion*, 418 F.3d 1282 (Fed. Cir. 2005).
3. *Union Carbide v. Shell Oil*, 425 F.3d 1366 (Fed. Cir. 2005).
4. *AT&T v. Microsoft*, 414 F.3d 1366 (Fed. Cir. 2005).
5. *Deepsouth Packing Co. v. Laitram Corp.*, 409 U.S. 902 (1972).
6. *Pellegrini v. Analog Devices, Inc.*, 375 F.3d 1113 (Fed. Cir. 2004).
7. *Standard Havens Prods., Inc. v. Gencor Indus., Inc.*, 953 F.2d 1360 (Fed. Cir. 1991).
8. *Union Carbide v. Shell Oil*, 434 F.3d 1356 (Fed. Cir. 2006). Judge Dyk dissented without comment or opinion.
9. Jess Bravin, “Patent Holders’ Power is Curtailed; High Court Rules Intent of Original Law Exceeded; More Disputes May Arise,” *Wall Street Journal*, May 1, 2007, at A3.
10. See S.B. 1145. A comprehensive collection of materials relating to the Patent Law Reform Act can be found at www.jonesday.com/patentlawreformupdates.
11. *Semiconductor Energy Lab. Company Ltd. v. Chi Mei Optoelectronics Corp.*, 2007 WL 1793770 (N.D. Cal. June 19, 2007). *But see* *Lucent*

- Technologies Inc. v. Gateway, Inc.*, 2007 WL 2274416 (S.D. Cal. Aug. 6, 2007) (declining to limit the scope of the contributory infringement statute, 35 U.S.C. § 271(c), in the way that *Microsoft* limited Section 271(f)).
12. *Informatica Corp. v. Business Objects Data Integration, Inc.*, 489 F.Supp.2d 1075 (N.D. Cal. 2007).
13. *Informatica Corp. v. Business Objects Data Integration, Inc.*, 2007 U.S. Dist. LEXIS 62743 (N.D. Cal. 2007).
14. See, e.g., *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster*, 545 U.S. 913 (2005) (using precedents on inducement of patent infringement to inform the proper legal standard for inducing copyright infringement); *eBay, Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006) (relying on precedents declining injunctions in copyright-infringement cases to inform the proper legal standard for injunctions in cases of patent infringement).
15. See, e.g., *Feist Publications, Inc. v. Rural Telephone Serv. Co.*, 499 U.S. 340, 344–345 (1991).
16. See *In re Nuijten*, 500 F.3d 1346 (2007).
17. *Id.* at 1353–1357.
18. *KSR Int’l Co. v. Teleflex Inc.*, 127 S. Ct. 1727 (2007).

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