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High court to rule on territorial reach of patents

Software industry eagerly awaits outcome of 'AT&T v. Microsoft.'

By Michael P. Sandonato
and Kristin Hogan
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PATENT

IT IS A SUPPOSED AXIOM that patents are territorial in nature. U.S. patents are enforceable in the United States, Mexican patents are enforceable in Mexico and Australian patents in Australia. But under the current law of the U.S. Court of Appeals for the Federal Circuit, U.S. patents on software can in some cases reach beyond the U.S. borders and be utilized to obtain damages on software products that are both manufactured and sold overseas. This controversial rule is currently on appeal to the U.S. Supreme Court in *AT&T Corp. v. Microsoft Corp.*, 414 F.3d 1366 (Fed. Cir. 2005), and the outcome is eagerly awaited by the software industry, legal practitioners and scholars alike.

The dispute revolves around the interpretation of 35 U.S.C. 271(f)(1), which makes anyone who supplies all or a substantial portion of the "components" of a patented invention from the United States an infringer, if the components are supplied in a manner that actively induces their combination outside of the United States into something that is covered by a U.S. patent. This statute was originally written to close a perceived loophole in the patent law brought to light by *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972). The defendant manufactured the parts of a shrimp deveining machine in the United States, and shipped them to foreign countries to be combined and sold. The *Deepsouth* court held that the shipment of the parts was not patent infringement, because to find otherwise would incorrectly give global reach to U.S. patent law. Id. at 531. Congress then passed § 271(f) to overrule this holding and create liability for such activities.

Fast-forward more than 30 years from *Deepsouth*, when patent disputes over software and technology are much more common than disputes over shrimp deveiners. In *AT&T v. Microsoft*, AT&T sued for patent infringement, alleging that Microsoft's flagship Windows product containing speech codecs infringed a patent owned by AT&T. A speech codec is a software program capable of converting a speech signal into a more compact code, and converting the compact code back into a signal that sounds like the original speech signal. See *AT&T Corp. v. Microsoft Corp.*, No. 01 Civ. 4872, 2004 U.S. Dist. Lexis 2394 (S.D.N.Y. March 5, 2004). To facilitate international distribution of this product, Microsoft supplied a limited number of master versions of the Windows software from the United States to foreign manufacturers, which copied these master versions and installed the copies on foreign-assembled computers that were then sold to foreign customers. These master versions were sent abroad either on so-called "golden master disks" or electronically.

AT&T alleged that Microsoft was thus liable under § 271(f) for supplying "components" from the United States that were combined elsewhere in such a manner as to be infringing. Microsoft argued in its defense that software is intangible information that cannot be "combined" with anything, and therefore software cannot be considered a "component" of a patented invention. Furthermore, even if software could be a "component" of an invention, no "components" were supplied from the United States to be combined abroad because none of the actual disks Microsoft supplied was used to install the software on computers abroad; rather, copies were made from those disks in foreign countries and then the copies were installed on computers.

Initial losses for Microsoft

The district court denied Microsoft's motion for partial summary judgment, stating that the patentability of software was well-established and that the statute did not limit "components" to tangible parts. It also ruled that copies made abroad from Microsoft's master disks could not be protected from liability under § 271(f), since the purpose of the statute was to prohibit the circumvention of infringement liability through supplying parts to foreign manufacturers for assembly abroad. The parties then agreed to the entry of a stipulated final judgment against Microsoft, which expressly reserved Microsoft's right to appeal on the § 271(f) issue.

On appeal, the Federal Circuit affirmed the judgment of the district court. It quickly dispatched the question of whether software can be a "component" of a patented invention, citing *Eolas Techs. Inc. v. Microsoft Corp.*, 399 F.3d 1325 (Fed. Cir. 2005), a case with very similar facts that had been decided while the appeal in the *AT&T* case was pending.

On the more complicated question of whether software copied abroad from a master disk supplied from the United States should itself be deemed "supplied" from the United States for purposes of § 271(f), the Federal Circuit reasoned that the "supplying" of software commonly involves generating a copy, such as when a user downloads software from a server on the Internet. Therefore, the court said, copying is "part and parcel of software distribution," so that for software inventions, copying is subsumed in the act of supplying. This means that sending a single copy of the software abroad, with the intent that it be replicated, can open the sender up to § 271(f) liability for all foreign-made copies. The court also noted the statute's history, particularly the fact that it was intended to close the perceived loophole in the patent law created by the *Deepsouth* case, and stated that because the statute was remedial in nature, it should be "construed broadly to effectuate its purposes."

At issue is software copied abroad from master disks.

Microsoft petitioned the Supreme Court for a writ of certiorari, which was eventually granted. In its brief, Microsoft characterized software as "nothing more than a set of instructions, known as code, that directs a computer to perform specified functions or operations," and argued that this set of instructions—merely a set of 1s and 0s designed to tell a computer whether to close or open a particular switch—is not in itself patentable, and cannot be a component of a patented invention. Even if it could, Microsoft claimed, it did not "supply" the infringing foreign-manufactured copies; it merely supplied master disks from which those copies were replicated, and none of the master disks was ever "combined" with a foreign-manufactured computer.

Arguments and responses

Microsoft argued that extending § 271(f) to cover such foreign manufacturing activities would effectively "grant monopolies" to patent holders abroad as well as in the United States, thus dampening the right of American companies to compete with patent holders abroad. Microsoft also pointed out that the Supreme Court has long held that courts must adopt any reasonable construction of a statute that avoids extraterritorial application.

Microsoft also argued that the Federal Circuit's

Michael P. Sandonato is a partner at New York's Fitzpatrick, Cella, Harper & Scinto, where he specializes in patent disputes involving electronic and computer technologies. Kristin Hogan is an associate at the firm.

holding will have a chilling effect on the U.S. software industry. For example, software companies could be forced to relocate not only their manufacturing facilities overseas, but also their research and development facilities, at which point they would no longer be American businesses at all. Microsoft further argued that software code is design information, and if design information can constitute a component of a patented invention, then the export of blueprints, formulas and methodologies would constitute infringement as well, thereby giving U.S. patents global force and effect.

Some other consequences predicted by Microsoft include a reduction in the incentive for inventors to obtain patents in jurisdictions other than the United States, and the threat of disrupting foreign nations' patent law schemes. Further, Microsoft's brief pointed out that this decision retroactively exposes software companies to infringement liability for foreign activities, which can have a large impact on their overall liability. This threatens their existing investments in overseas manufacturing facilities built in reliance on their safety from American patent law in foreign markets.

Addressing Microsoft's arguments on the impact of the decision on the U.S. software industry, AT&T argued in its reply brief that to rule in favor of Microsoft would create special treatment for software inventions, thereby subverting the protection of U.S. patents. Moreover, AT&T argued that Microsoft's extraterritoriality arguments were inapplicable because in this case, the statute was specifically intended to reach the activities of domestic suppliers. It essentially dismissed Microsoft's parade of horribles for the software industry as exaggerations or red herrings.

In opposition, AT&T argued that software may often be the only device that distinguishes a patented invention from a general-purpose computer, and thus it follows logically that the software must be a component of that patented invention. It argued that nothing in the ordinary meaning of the term "component" excludes software, and that software is different from other information or sets of instructions because it is actually a functional part of a device being manufactured. Moreover, AT&T contended that to treat Microsoft's supply of master disks to foreign manufacturers as a noninfringing activity would eviscerate the remedial purpose of § 271(f), leaving open the *Deepsouth* loophole that Congress intended to close.

U.S. sides with Microsoft

The United States filed an amicus curiae brief in support of Microsoft. While it agreed with the Federal Circuit's decision that software could be a component of a patented invention, it disagreed as to whether Microsoft's activities constituted the "supplying" of such a component from the United States to foreign manufacturers. Like Microsoft, the government accused the Federal Circuit of improperly extending U.S. patent law to foreign markets and putting U.S. software companies at a competitive disadvantage relative to their foreign competitors. It also focused on the Federal Circuit's holding that for software, the act of copying is subsumed in the act of supplying, and attacked this as an unwarranted leap of logic. In the government's view, no copy physically made overseas can possibly have been "supplied" from this country, and software should be treated equally with all other types of inventions.

The Houston Intellectual Property Law Association filed a similar brief, in support of neither party, but essentially agreeing with the government's position that the court should affirm the Federal Circuit's holding as to whether software could be a component of a patented invention, but reverse its holding that Microsoft had "supplied" such a component from the United States. In particular, this brief highlighted the fact that software should not be treated differently from other components of inventions. It stated that software does not have to be separately patentable in order to be a component of a patented invention, and that Microsoft's attempts to liken software information to a set of design instructions or, alternatively, a mold for a tangible product such as a tire, fails because software differs from these things in that it can actually be incorporated and stored within a patented product, while the others cannot.

The Patent, Trademark and Copyright Section of the District of Columbia Bar also filed an amicus brief focusing on the Federal Circuit's interpretation of "supplying" components. It criticized the Federal Circuit for not using a plain-meaning analysis of the law, and instead effectively modifying the statute by holding that the components in question were "essentially" supplied from the United States. It also suggested that the Federal Circuit's decision may violate the international treaty TRIPS (Trade-Related aspects of Intellectual Property Rights), which states that all inventions must be treated in the same manner.

On the topic of international implications, the Fédération Internationale des Conseils en Propriété Industrielle (FICPI) filed the most comprehensive amicus brief. Its paper focused almost entirely upon how the Federal Circuit's interpretation of the law potentially interferes with the patent systems of other nations. Like many of the other briefs, this brief pointed to the presumption against extraterritorial application of U.S. laws, but it also went a big step further by contending that § 271(f) is ultra vires—that it is beyond the authority of Congress to regulate acts occurring solely in foreign countries.

Furthermore, FICPI suggested that § 271(f) is a violation of the Paris Convention, which states that patents are independent and patent infringement cannot be found when the acts of alleged infringement take place in a country outside the one where the patent is. Its brief also notes that there is significant international debate regarding the patentability of software, which underlines the need to avoid unnecessary extraterritorial application of U.S. law in this particular case.

Not surprisingly, numerous amicus briefs were filed from the software industry, including by Amazon.com, Yahoo! Inc., the Business Software Alliance, the Software & Information Industry Association, Intel Corp. and the Software Freedom Law Center. In general, these briefs focused quite a bit on the distinction between physical parts of an invention and design information, characterizing software as the latter, as Microsoft did.

The software industry's position essentially was that the Federal Circuit's decision was premised on a misunderstanding of the nature of software. For example, Yahoo argued that software can be a component of a patented invention, but not until it is installed on a computer, and therefore that Microsoft did not "supply" any of the components that were actually installed. Taking a slightly different stance, Amazon.com's brief likened Microsoft's software to computer-aided manufacturing (CAM) programs, pointing out that these programs are used to manufacture many billions of

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physical things around the world and that if such programs were treated the same as Microsoft's software, liability could attach for keys, screws and other such physical parts manufactured around the world, not simply for software copies. Many of the industry briefs discussed the presumption against extraterritorial application of U.S. law, as well as the potential adverse consequences on domestic software innovation.

Microsoft's petition for certiorari was granted on Oct. 27, 2006. Microsoft filed its main brief on Dec. 15. Not surprisingly, the arguments in its main brief largely parallel those made in its petition. To highlight what it calls the "absurdity" of the Federal Circuit's approach, Microsoft points out that if a domestic manufacturer sent a single shrimp deveining machine to a foreign manufacturer, which then disassembled the machine, created molds and built 100 foreign-made machines, the domestic manufacturer could not be liable for the 100 foreign-made machines, and it should therefore not be liable for the foreign-programmed computers either. Microsoft concludes its brief by positing that affirming the Federal Circuit would be tantamount to finding that a programmer who memorizes a computer program, flies to a foreign country and programs 100 computers there to function as special decoders would be an infringer.

AT&T's brief is due on Jan. 23. No date for oral argument has yet been set. NLJ