New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

Web address: http://www.nylj.com

VOLUME 234—NO. 34 THURSDAY, AUGUST 18, 2005 ALM

Outside Counsel

BY DAVID A. KALOW AND MILTON SPRINGUT

The Increasingly Long Arm of U.S. Patent Law

In order to escape the reach of U.S. patents, a number of companies have tried to satisfy their foreign markets by exporting from the U.S. some or all of the components of their products and assembling them overseas.

In response and with help of a statute enacted by Congress over 20 years ago, patent holders have aggressively tried to prevent these activities.

On July 13, 2005, in *AT&T Corp. v. Microsoft*,[1] the U.S. Court of Appeals for the Federal Circuit (Federal Circuit) expanded the rights of patent holders in these situations, by allowing a patent to be asserted with respect to foreign activities when the components themselves were merely derived from a master copy that was exported from the U.S.

As companies consider how they will form global patent strategies, and in light of the teachings of *AT&T v. Microsoft*, clients (and lawyers) are well-advised to pay attention to these developments so that they can more efficiently make use of their own patents and avoid infringing the rights of others.

Legal Framework

Historically, patent rights were recognized solely on a nation-by-nation basis, and the only activities that could be limited by another's patent were those activities that occurred within the borders of the country that recognized the patent. However, in 1984, Congress recognized that it would be advantageous to prevent an infringer from evading a patent by shipping a portion or all of the activities overseas, and it enacted 35 USC §271(f). Four years later,

David A. Kalow *Milton Springut*

In 'Microsoft,' the court expanded patent holders' rights by allowing a patent to be asserted with respect to foreign activities when the components are derived from a U.S. master copy.

Congress recognized that infringers were avoiding process patents by conducting the processes overseas and importing the final products. In response, it enacted 35 USC §271(g).

Subsection (f) of §271 was a legislative response to a holding by the Supreme Court[2] that allowed infringers to escape liability by exporting and then assembling components in other countries. Accordingly, §271(f) prohibits the exporting of components from the U.S. either: (1) in a manner to actively induce their combination in a way that would be covered by a patent if done within the U.S.;[3] or (2) while knowing of the limited use of components that are not staple articles or commodities of commerce suitable for noninfringing uses, intending that the components would be combined in a manner that would be covered by a patent if done within the U.S.[4]

Section 271(g) is directed to prohibiting the import (as opposed to §271(f) export) of products made by processes that if completed in the U.S. would have infringed a U.S. patent. Although outside of the scope of this article, §271(g) has been the focal point of a number of important litigations as well.

Cases and §271(f)

The Federal Circuit issued its opinion in *AT&T v. Microsoft* on July 13, 2005 in the wake of two decisions involving §271(f) that were issued in the past 12 months.

First, in *Pellegrini v. Analog Devices, Inc.*[5] (July 2004) the Federal Circuit confronted the issue of whether components that are manufactured outside of the U.S. and never physically shipped to or from the U.S. are nevertheless components for purposes of §271(f), if, however, the components are designed within the U.S. and the instructions for manufacture are transmitted from within the U.S. The court held not, and that the components must be physically present in the U.S. and then sold or exported for there to be liability for those activities.

Second, in *Eolas Technologies and The Regents of the University of California v. Microsoft*,[6] (March 2005) the Federal Circuit was asked to determine whether software code made in the U.S. and exported abroad is a component of a patented invention. The court reasoned that because software qualifies as an invention eligible for patenting, and §271(f) was not limited to patented machines or physical structures, software may be a component within the scope of §271(f).

'AT&T v. Microsoft'

Against this backdrop, in *AT&T v. Microsoft*, Microsoft had been satisfying foreign markets by sending a master version of its Windows operating system to foreign computer manufacturers in Germany and Japan. Microsoft authorized foreign

David A. Kalow *and* **Milton Springut** *are partners at Kalow & Springut.* **Scott D. Locke,** *also a partner at the firm, assisted in the preparation of this article.*

replicators to replicate the master versions in generating multiple copies of Windows for installation on foreign-assembled computers. These computers were then sold to foreign customers. The master versions contained speech codecs that when installed on a computer, infringed a patent owned by AT&T. On appeal, Microsoft asserted that there could be no infringement under §271(f) for two reasons: (i) computer software was not a component within the meaning of §271(f); and (ii) because the software was replicated abroad, it was not supplied from the U.S., and thus Microsoft's activities were not within the scope of the statute.

First, the Federal Circuit applied *Eolas*, which had been pending at the time that Microsoft lodged its appeal. Thus, without needing to provide significant analysis, the court reiterated that software could be a component for purposes of §271(f).

Second, the court confronted what it termed a question of first impression: "whether software replicated abroad from a master version exported from the U.S.—with the intent that it be replicated—may be deemed 'supplied' from the United States for the purposes of §271(f)."

Microsoft had emphasized that there should be no liability because the foreign copies were not supplied or caused to be supplied from the United States. Instead, Microsoft argued that the foreign copies were manufactured abroad by encoding a storage medium with the Windows software. Thus, the master disk originated in the United States with Microsoft, but according to Microsoft, the components—the replicated copies—were not sent from the U.S.

The Court of Appeals disagreed, focusing on the meaning of the term "supplied" in the statute. It analyzed the term as understood by the software community and held that for software components, "the act of copying is subsumed in the act of 'supplying,' such that sending a single copy abroad with the intent that it be replicated invokes §271(f) liability for those foreign-made copies." Underscoring its belief that the statute needed to be interpreted in view of the technology to which it is applied the court emphasized: "we cannot disregard the nature of the relevant technology and business practices underlying a particular litigation."

The court's view that patent statutes must be applied in view of the technology at issue is not surprising to anyone who has prosecuted or litigated biotechnology patents. As persons familiar with those technologies are aware, those patents and applications have for years implicitly been subject to heightened application of the written description and enablement standards.[7] However, now the court has made its rules for applications of statutes explicit, i.e., they may be applied differently for different technologies.

In a further attempt to save itself from a finding of liability, Microsoft argued that software sent by electronic transmission should be treated differently than software shipped by disks. However, the court responded that liability would not depend on the medium used for exportation. To buttress its holding, the court reviewed the policy behind §271(f) and cited the Congressional Record, which specifically referenced that the section was enacted in order to allow the patent system to be responsive to challenges of a changing world. The court also noted that the section was remedial in nature and thus was to be construed broadly.

In light of 'AT&T v. Microsoft,' the U.S. computer industry may have more reasons to outsource and send masters from one non-U.S. country to another.

In light of the holding of *AT&T v. Microsoft*, the U.S. computer industry may find itself subject to increasingly large claims of patent infringement, i.e., claims that are directed not only to domestic activities but foreign activities that trace back to the export of component parts such as software code from the U.S. Consequently, the industry may have even more reasons to outsource, e.g., develop code in India or elsewhere and send masters from one non-U.S. country to another, never touching the U.S.

Given the potential exposure for Microsoft, one would expect it to file a petition for rehearing, and ultimately an appeal to the U.S. Supreme Court. It would seem that the decision's explicit reference to applying statutory language in light of technological developments and differently depending on the field will bate the more strict constructionists on the Supreme Court to grant certiorari. The likelihood of such an appeal is particularly strong in light of the dissent by Judge Rader, which is almost as long as the opinion itself.

The grounds for reversal identified by Judge Rader include: (i) a disregard for the international scheme of patent law, namely that acts that occur primarily outside of the U.S. should be judged by the laws of that country, not by over-extension of U.S. law; (ii) the misconstruction of the term "supplies" to include copying, replicating and reproducing, which are in effect manufacturing; (iii) improperly basing statutory construction on the technology to which it is applied; (iv) the fact that the components were not shipped from the U.S., but instead they were generated abroad; (v) the improper reliance on congressional intent because the majority misunderstood the policy behind §271; and (vi) improperly applying the text of §271 that reads "supplied in or from the U.S.," which was rendered superfluous by the majority's construction since it allows liability to be imposed when the copying was conducted in Germany and Japan.

AT&T v. Microsoft is significant for at least three reasons. First, if the holding is not altered on appeal or by legislative action, it will undoubtedly cause the computer industry to reexamine its global operations, including where it conducts business and its patent strategy. Second, the case suggests an expansive view of the territorial reach of U.S. patents. Third, by emphasizing that the patent law is to be interpreted in light of the technologies to which it is applied, the Federal Circuit has opened the door for patent litigants to assert that based on the type of patent at issue, courts may apply different legal standards. By laying the foundation for this type of argument, one must ask whether the Federal Circuit has acted inappositely to its mandate of creating uniformity in the patent laws.[8]

1. CV-04-1285 (Fed. Cir. July 13, 2005).
2. *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972).
3. 35 U.S.C. § 271(1).
4. 35 U.S.C. § 271(2).
5. 375 F.3d 1113 (Fed. Cir.), cert. denied, 125 S. Ct. 642 (2004).
6. 399 F.3d 1325 (Fed. Cir. 2005).
7. 35 U.S.C. § 112.
8. *Electronics for Imaging v. Coyle*, 392 F.3d 1341 (Fed. Cir. 2005).