

New York Law Journal



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

VOLUME 234—NO. 51

TUESDAY, SEPTEMBER 13, 2005

ALM

COMPUTER LAW

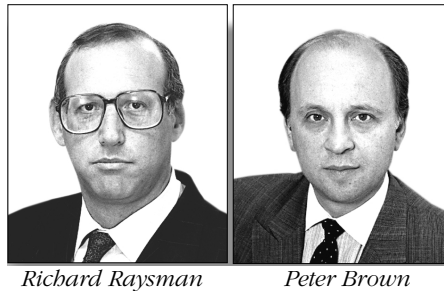
BY RICHARD RAYSMAN AND PETER BROWN

'AT&T v. Microsoft': Patent Infringement and Exported Software

Historically, the reach of patent law did not extend outside United States borders, but a growing line of cases has begun to do just that with respect to exported computer software. While much of the law on patent infringement was written before the growth of computer software and the Internet, the courts, in their statutory interpretations of applicable laws, are beginning to catch up. On July 13, 2005, the Federal Circuit, in *AT&T v. Microsoft*, 414 F.3d 1366 (Fed. Cir. 2005), ruled on an issue that lower courts found troubling, namely, whether a software company is liable for indirect infringement under §271(f) of the patent law for exporting software abroad for eventual copying and foreign distribution.

This article will generally discuss infringement under §271(f) of the patent law in light of the *AT&T v. Microsoft* decision, as well as how the decision changes the legal landscape with respect to the export of computer software. With the recent spate of high jury verdicts for patent infringement, the Federal Circuit's new interpretation of a section of patent law certainly resounds in Silicon Valley. The Federal Circuit's ruling is important

Richard Raysman and Peter Brown are partners at Brown Raysman Millstein Felder & Steiner. They are co-authors of "Computer Law: Drafting and Negotiating Forms and Agreements" (Law Journal Press).



Richard Raysman

Peter Brown

to counsel responsible for assessing possible patent infringement, as well as software companies that increasingly rely on outsourcing to distribute software in foreign markets.

The Case Below

In 2004, AT&T brought an infringement action against Microsoft in the Southern District of New York (See *AT&T v. Microsoft*, 2004 U.S. Dist. LEXIS 3340 (SDNY, March 5, 2004)). AT&T alleged that Microsoft infringed upon its speech codes patent, a program that codes a speech signal into a more compact form, and decodes it back into a signal that sounds like the original speech signal, when it produced copies of its Windows operating system abroad (containing the infringing code) that had been replicated from a master version sent from the United States. To facilitate international distribution of Windows, Microsoft, like many other software companies, uses one of two methods: "golden master" disks or encrypted

electronic transmission.

A golden master disk is simply a master CD that contains the machine-readable object code of the software. A limited number of golden disks are then shipped from the United States to foreign manufacturers (called "original equipment manufacturers," or OEMs). Pursuant to a licensing agreement with Microsoft, the OEMs use the golden disks as templates to create multiple copies of Windows for installation on foreign-assembled computers that are then sold to foreign customers. Encrypted electronic technology, on the other hand, involves sending the software code in the form of an encrypted electronic transmission via the Internet that the OEM then downloads and installs on the foreign computers.

Microsoft moved for summary judgment, claiming that 35 U.S.C. §271(f), which prohibits foreign assembly of infringing goods supplied from the United States, was inapplicable in this case. Microsoft argued that its acts fell outside the scope of §271(f) because the software contained on its golden disks was merely "intangible information" and not a "component" as defined under §271(f). Microsoft also contended that since the replication of the software took place abroad, the Windows software installed on foreign computers could not be deemed to have been "supplied" from the United States as required by the statute.

The trial court denied Microsoft's

motion for partial summary judgment. Based upon the entry of a stipulated final judgment, the district found Microsoft liable for patent infringement under §271(f), while expressly reserving Microsoft's right to appeal that issue. Specifically, the trial court found that Microsoft was liable under §271(f) for copies of Windows that had been replicated abroad from a master version sent from the United States. The court rejected Microsoft's arguments that the software contained on the golden disks was not a "component" and that foreign-replicated copies were not "supplied" from the United States as contemplated under the statute.

Section 271(f)

The Federal Circuit affirmed the lower court's decision. Following its precedent in *Eolas Techs. Inc. v. Microsoft Corp.*, 399 F.3d 1325 (Fed. Cir. 2005), the court reasoned that "software code alone qualifies as an invention eligible for patenting, and that the statutory language did not limit §271(f) to patented 'machines' or patented 'physical structures,' such that software could very well be a "component" of a patented invention for the purposes of §271(f)." *AT&T* at 1369. In an issue it deemed one of first impression, the court also clarified the meaning of "supplied" under §271(f). The court held that software exported from the United States—with the intent that it be replicated—that is then replicated abroad from a master version may be deemed "supplied" from the United States for purposes of §271(f). Seemingly agreeing with the lower court's analogy, unlike a "mold for tires that is exported to a foreign plant to make tires for combination in foreign-made cars," Microsoft's software has already been manufactured in, and supplied from the United States and is only copied abroad, not created anew by

the OEM. *AT&T*, 2004 U.S. Dist. LEXIS 3340 at *26.

Section 271(f) of the patent law was enacted to prevent infringers from evading liability by manufacturing or supplying a component of a patented invention from the United States and exporting it for combination into an end product overseas. *Imagexpo LLC v. Microsoft Corp.*, 299 F. Supp. 2d 550, 551

Microsoft cautioned that if the court broadened the scope of §271(f) to include software shipped and copied abroad, ... "doomsday" would befall the industry.

(E.D. Va. 2003). To be liable, the infringers must possess the intent that a component will be combined outside the U.S. in a manner that would be infringement if the act occurred within the U.S. Components supplied from foreign countries and incorporated into foreign-assembled products are not covered by §271(f).

The statute describes two ways a manufacturer can be held liable for inducing or contributing to infringement. Courts have interpreted the statute to mean that a manufacturer can be held liable when it exports all or a substantial portion of the components of a patented invention for assembly and distribution overseas. *Id.* at 552. Also, a manufacturer risks liability by exporting any component that is either specially made or specially adapted for use in the invention but is not a staple article or commodity of commerce suitable for substantial, non-infringing use. *Id.* The Federal Circuit stated that the statute was not merely "housekeeping oriented" but "remedial in nature" and Congress intended §271(f) to have extraterritorial effect to the extent that

the exportation was facilitated by acts in the United States. *AT&T*, 414 F.3d at 1371.

To better understand patent infringement under §271(f) requires knowledge of prior developments. Section 271(f) was enacted in response to *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972), a case in which the United States Supreme Court noted a loophole in the law allowing infringers to escape liability under patent law by finishing product assembly in a foreign country. Following the decision, Congress, as part of the Patent Law Amendments Act of 1984, enacted §271(f) to prevent infringers from exploiting the loophole. The *Deepsouth* case involved a patent dispute over shrimp de-veining machines, and it is only in the last few years that courts have begun to broaden the application of §271(f) to include not just traditional machines but computer software.

Uncertainties Ahead

Courts face novel issues about how to construe intangible goods like software. In interpreting §271(f), the Federal Circuit followed its own precedent in *Eolas* in holding that software was indeed a "component" under the statute, leaving the only remaining issue being whether Microsoft "supplied" the software. Using ordinary statutory interpretation, the court analyzed the term in the context of the software industry. The court noted: "It is inherent in the nature of software that one can supply only a single disk that may be replicated—saving material, shipping, and storage costs—instead of supplying a separate disk for each copy of the software to be sold abroad." *AT&T* at 1370.

Unlike the shipment of tangible goods or machines, the supplying of software with the intent that it be replicated inherently involves the making of copies, whether from a physical disk or

electronically transmitted and downloaded from the Internet. Following the court's thinking, liability is neither predicated on the medium used for exportation nor the number of disks shipped abroad, rather all resulting copies from the original golden disk will be deemed to have been "supplied" from the United States. *Id.* Simply put, sending a single copy abroad with the intent that it be replicated invokes §271(f) liability for any resulting foreign-made copies. *Id.* at *8.

Including the *Imagexpo* and *Eolas* cases, a handful of courts had ruled that exported software used in foreign computers or systems is a "component" under §271(f), but the *AT&T* court was the first to clarify the issue of "supplied" under the statute.¹ Now that the Federal Circuit has spoken on the issue of exported software and liability under §271(f), exactly what lies ahead remains unknown. Much is at stake for companies that manufacture and distribute software, since software patent infringement damage calculations under §271(f) are augmented to factor in global sales. For example, in the *Imagexpo NetMeeting* case of 2003, a jury fined Microsoft \$62.3 million for infringement (the case was later settled for \$60 million),² and in the *Eolas Internet Explorer* case, Microsoft was hit with a \$565 million verdict (an appeals court subsequently remanded the case back to the district court for reconsideration and the case remains in litigation).³

Despite the reach of the *AT&T* decision, limitations on §271(f) liability can be found in *Pellegrini v. Analog Devices, Inc.*, 375 F.3d 1113 (Fed. Cir. 2004), where the Federal Circuit found no §271(f) liability for the exportation of instructions for foreign manufacture and disposition of computer chips. In *Pellegrini*, the Federal Circuit held that liability may exist only where a component itself—as opposed to instructions for manufacturing

the component or management oversight—has been supplied or caused to be supplied in or from the United States. *AT&T* at 1370 (quoting *Pellegrini*).

The Federal Circuit was careful to distinguish the two cases, marking a difference between an actual component (i.e., the golden disks containing the Windows software code) that is ready for installation to form an infringing apparatus and mere instructions to foreign software engineers for designing and coding a system. In future patent infringement disputes, parties will likely consider the *Pellegrini* exception when assessing whether §271(f) applies to foreign distribution methods involving, for example, new outsourcing technologies.

Going forward, software companies and their licensees might confront increased exposure for foreign infringement in light of the expansion of §271(f). Accordingly, practitioners would be prudent to advise software companies about the changing area of law surrounding patent infringement and software makers ought to take the opportunity to investigate the possibility of infringing products being shipped and sold overseas.

Conclusion

In its briefs, Microsoft cautioned that if the court broadened the scope of §271(f) to include software shipped and copied abroad, a "parade of horrors" or "doomsday" would befall the industry, such as the relocation of manufacturing facilities overseas and the exportation of American jobs, not to mention unfair market advantages for foreign competitors not beholden to §271(f).⁴ The Federal Circuit dismissed these policy arguments and the District Court commented that such "concerns are better addressed through manufacture of non-infringing goods or Congressional action...." *AT&T*, 2004 U.S. Dist. LEXIS at *28. Already, the recent court decisions

and verdicts have made ripples, as legislation has been introduced in the House of Representatives seeking to curb patent lawsuits.⁵ Thus, it remains to be seen how the software industry, or other industries in which master copies or molds are exported abroad, will be affected by the Federal Circuit's ruling and whether Congress will ultimately act.



1. See also *NTP, Inc. v. Research in Motion, Ltd.*, 261 F.Supp.2d 423 (E.D. Va. 2002), where a district court granted summary judgment involving infringement under 271(f), finding that the defendant's transmission network for its Blackberry wireless devices manufactured in Canada fell within section 271(f) because it incorporated domestically-shipped components that the defendant combined outside the United States. On appeal, the Federal Circuit, among other rulings, reversed part of the lower court's decision concerning section 271(f), holding that "by merely supplying products to its customers in the United States, RIM is not supplying or causing to be supplied in this country any steps of a patented process invention for combination outside the United States and cannot infringe on NTP's asserted method claims under section 271(f) as a matter of law." *NTP, Inc. v. Research in Motion, Ltd.*, 2005 U.S. App. LEXIS 15920 at *108 (Fed. Cir., Aug. 2, 2005).

2. See Paul Festa, "Microsoft Settles in Whiteboard Patent Dustup," CNET news.com (Dec. 26, 2003), available at http://news.com.com/2100-1014_35133588.html.

3. See Paul Festa, "Microsoft Seeks Rehearing in Eolas Case," CNET news.com (March 22, 2005), available at http://news.com.com/Microsoft+seeks+rehearing+in+Eolas+case/2100-1014_3-5630270.html.

4. *AT&T*, 414 F.3d. at 1372. See also "The Application of Domestic Patent Law to Exported Software: 35 U.S.C. §271(f)," 25 U. Pa. J. Int'l Econ. L. 557, n.150 (2004).

5. See Bloomberg News, "Software Industry Seeking Changes in US Patent Law," (July 6, 2005), available at http://www.boston.com/business/globe/article_1_e_s_/2005/07/06/software_industry_asking_changes_in_us_patent_law/.