

Vol. 22 No. 20

June 8, 2007

# A PATENTED COURT TERM: *KSR, MICROSOFT & MEDIMMUNE'S* IMPACT ON IP AND INNOVATION

by

Robert P. Parker

In its term now coming to a close, the U.S. Supreme Court reviewed three patent decisions of the U.S. Court of Appeals for the Federal Circuit. That the Supreme Court decided to hear three patent cases in one term, and that the Court reversed the Federal Circuit in each case, suggests that the Justices intended to make a mark on the patent law and set a new direction. But did they? At first blush, the decisions appear to establish new rules that govern what patent cases will be heard, how patent cases will be decided and how individual patents will be judged. As the decisions are put to the test of further analysis by patent owners, patent litigators, district court judges, and ultimately the Federal Circuit itself, the results may be quite different. Even now, as discussed below, the Court's decisions seem to raise as many questions as they answer.

***KSR International Co. v. Teleflex, Inc.*, 127 S. Ct. 1727 (2007).** In *KSR*, the Court reviewed the Federal Circuit's unpublished decision upholding the validity of respondent's patent for an adjustable automobile pedal with an electronic sensor. The Supreme Court had little trouble finding the patent invalid for "obviousness," concluding that the two elements of the invention (the pedal and the sensor) were well known in the prior art, and that the benefits and skill necessary to combine them would have been clear prior to the formulation of the patented device.

In the course of reaching its decision, the Court addressed more broadly the Federal Circuit's jurisprudence on the issue of obviousness. Obviousness questions arise by virtue of a statutory provision, 35 U.S.C. § 103, which states that "a patent may not be obtained . . . if differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which the subject matter pertains." In a 1966 decision, *Graham v. John Deere Co.*, 383 U.S. 1 (1966), the Supreme Court provided a framework for determining whether a patent is invalid for obviousness. In relevant part, the Court directed that, when applying Section 103, "the scope and content of the prior art are to be determined; differences between the prior art and the [patent] claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved." Then, "[a]gainst this background, the obviousness or nonobviousness of the subject matter is determined." *Id.* at 1734, quoting *Graham v. John Deere Co.*, 383 U.S. at 17-18.

The *Graham* analysis raised two concerns, both recognized by the Supreme Court at the time. First, the obviousness analysis should be objective, not subjective. Second, the courts should not resort to hindsight, as any invention might seem obvious after it has been disclosed and explained. The *Graham* decision called for an objective, *a priori* analysis.

---

**Robert P. Parker** is a partner with the law firm Paul, Weiss, Rifkind, Wharton & Garrison LLP, Washington, D.C. The ideas offered in this paper are those of the author, and do not necessarily reflect the views of the firm or any other entity.

Grappling with this standard, the Federal Circuit established a so-called “teaching-suggestion-motivation” or “TSM” test. By this test, the party challenging the patent would have to show not only that the prior art laid a foundation for the invention, but also that the prior art offered some teaching, suggestion or motivation to combine the prior art in the fashion claimed by the challenged patent. By this standard, it seemed, the Federal Circuit had resolved the hindsight problem (the TSM had to come *from* the prior art) and the objectivity issue (the TSM had to be *in* the prior art).

The Court in *KSR* “beg[a]n by rejecting the rigid approach of the Court of Appeals” in favor of “an expansive and flexible approach” dictated by Supreme Court precedent. 127 S. Ct. at 1739. Canvassing decisions in which it had applied the *Graham v. John Deere* factors, the Court drew from its precedent that “[t]he combination of familiar elements according to known methods is likely to be obvious when it does no more than yield predictable results.” *Id.* In only one of its prior decisions applying Section 103 and *Graham v. John Deere* had the Court upheld the patent. In that case, *United States v. Adams*, 383 U.S. 39 (1966), the inventor had patented a type of battery that differed from prior designs in its use of water and other elements not typically found in battery designs. In that case, the Court noted, the prior art had taught away from the use of these materials. “The fact that the elements worked together in an unexpected and fruitful manner supported the conclusion that Adams’s design was not obvious to those skilled in the art.” 127 S. Ct. at 1740. The Court’s opinion in *KSR* is replete with admonitions that “the predictable use of prior art elements according to their established functions” is not likely to satisfy Section 103, and a patent that claims an invention of that type will fail on obviousness grounds. *Id.*

Yet, later in its opinion, the Court took pains to acknowledge two Federal Circuit decisions handed down after the Court had granted certiorari in *KSR*, in which the court of appeals had applied a more flexible version of its TSM test. In one of those decisions, the Federal Circuit held (in language quoted by the Supreme Court): “There is flexibility in our obviousness jurisprudence because a motivation may be found *implicitly* in the prior art. We do not have a rigid test that requires an actual teaching to combine . . .” *Id.* at 1743, quoting *Alza Corp. v. Mylan Labs., Inc.*, 464 F.3d 1286, 1291 (Fed. Cir. 2006). In the other decision (also quoted by the Supreme Court), the Federal Circuit emphasized, “Our suggestion test is in actuality quite flexible and not only permits, but *requires*, consideration of common knowledge and common sense.” 127 S. Ct. at 1743, quoting *DyStar Textilfarben GmbH & Co. Deutschland KG v. C.H. Patrick Co.*, 464 F.3d 1356, 1367 (Fed. Cir. 2006). The Supreme Court did not endorse these decisions, and it noted that they did not resolve the problems it had identified in the somewhat harsh (perhaps even extreme) decision under review; but the Court allowed that “[t]he extent to which they [the more recent Federal Circuit decisions] may describe an analysis more consistent with our earlier precedents and our decision here is a matter for the Court of Appeals to consider in its future cases.” 127 S. Ct. at 1743.

What will the impact of *KSR* be on the future cases? If the lower courts take the Supreme Court’s discussion of its precedents, and the principles it drew from those cases, as the final word, then the TSM test is dead and the Court has dramatically changed the test for determining obviousness when a patent comprises a combination of known elements (as is often the case). By this test, a patent owner would have to show (as in *Adams*) that the combination worked in unpredicted ways to yield unexpected results. On the other hand, if the courts accept the invitation to consider the Federal Circuit’s recent decisions as an acceptable approach, then the TSM test – leavened by some measure of flexibility and “common sense” – is alive and well. Only time will tell.

***Microsoft Corp. v. AT&T Corp.*, 127 S. Ct. 1746, 2007 U.S. LEXIS 4744 (U.S. Apr. 30, 2007).** AT&T holds a patent for a device that digitally compresses and encodes recorded speech. AT&T accused Microsoft of infringement. For relevant purposes, the parties stipulated that a computer that runs certain Microsoft software potentially infringes the patent. Microsoft also acknowledged that, by licensing copies of its software to computer manufacturers for installation in the United States, it induced infringement of the AT&T patent. However, the AT&T patent covered neither the computer itself nor the software itself. 2007 U.S. LEXIS 4774 at \*18.

The question before the Supreme Court was whether the licensing of the Microsoft software for installation into computers outside the United States likewise infringed the patent. Under a 1972 decision, *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972), the answer would have been no. In that case, an accused infringer had manufactured the components of an infringing device, but shipped them abroad for

assembly. Noting that, by statute, infringement requires making, using or selling the patented article – not its parts – in the United States, the Court ruled that neither the domestic manufacture of constituent parts nor the assembly of those parts outside the country constituted infringement. Because there was no infringement, there also was no inducement to infringe by shipping the components for assembly abroad.

Congress passed a statute, codified at 35 U.S.C. § 271(f), to address *Deepsouth*. The statute provides in Section 271(f)(1) that, with certain caveats, a party that supplies components of a patented article from the United States “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.” Section 271(f)(2) applies the same principle to the supplier of a component of a patented invention “that is especially made or especially adapted for use in the invention.” AT&T based its infringement claim, insofar as it concerned the use of Microsoft software abroad, on these provisions.

As the Court described the relevant facts, Microsoft develops the software in question in the United States. It transmits the software to computer manufacturers in other countries. The computer manufacturers install the software into computers, thereby creating what would be, in the United States, infringing devices. The question before the Court was whether Microsoft was liable for infringement by virtue of Section 271(f). The Federal Circuit said yes. The Supreme Court said no.

The Court’s decision rested on how Microsoft transmitted the software to the computer manufacturers and the computer manufacturers loaded the software onto the computers. According to the Court: “Microsoft sends to each of the foreign manufacturers a master version of [the software], either on a disc or via encrypted electronic transmission. The manufacturer uses the master version to generate copies. Those copies, not the master sent by Microsoft, are installed in the foreign manufacturer’s computers.” 2007 U.S. LEXIS 4744 at \*17.

The Court began its analysis of the statute by noting that “no one in this litigation argues that software can *never* rank as a component under §271(f).” *Id.* at \*20. The Court then held, in essence, just that. Software, the Court said, is like a blueprint, or a set of instructions, “but it is not a combinable component of [the patented] device.” *Id.* at \*25. “Until it is expressed as a computer-readable ‘copy’ – *e.g.*, on a CD-ROM, [Microsoft’s] software – indeed any software detached from an activating medium – remains uncombinable. It cannot be inserted into a CD-ROM drive or downloaded from the Internet; it cannot be installed or executed on a computer.” *Id.* at \*24. Following that logic, the Court found that “the copies of [the software] actually installed on the foreign computers were not themselves supplied from the United States”, *Id.* at \*30 – rather, the copies of the software taken from the original Microsoft transmission were. As the concurring opinion noted, “[We] agree with the Court that a component of a machine . . . must be something physical.” *Id.* at \*43 (Alito, J., concurring). Given the Court’s view that nothing physical delivered from the United States was installed into the computers, the Court held that Section 271(f) did not apply.

Acknowledging the force of the arguments on each side of the question, the Court invited Congress to consider whether an amendment to the statute was in order. *Id.* at \*11. The first question that *Microsoft* raises, therefore, is whether Congress will take up that mantle and overrule the Court’s decision by legislation (as it had after the Court handed down *Deepsouth*).

But another question arises from the Court’s decision itself. The Court recognized the practice of delivering software electronically – indeed, it noted that Microsoft itself sometimes delivers a master copy of the software to the computer manufacturers by electronic means. What then of the case in which software is transmitted electronically directly to end users in other countries (or stored on a server in this country and downloaded abroad)? In that case, would the direct transmission from the United States, with no intervening copy between master and disc, render the software a “combinable component”? The language and logic of the Court’s opinion suggest that the answer is no, but the question was not squarely before the Court. One can readily imagine that, in months and years to come, as technology continues to develop, a “direct transmission” case, or other cases with scenarios that likewise differ from *Microsoft* in their technical particulars, will come before the lower courts. How those courts will deal with *Microsoft*, and the impact of *Microsoft* on the development of patent-law principles as applied to software generally, are important questions the Court has left open.

***MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007).** MedImmune will find a more comfortable home in future treatises on civil procedure and federal courts than in texts on patent law. MedImmune was a Genentech licensee. The parties disagreed on whether MedImmune owed royalties on a new Genentech patent, MedImmune being of the view that the patent was invalid. Genentech sent letters to MedImmune that MedImmune considered a threat of litigation if MedImmune failed to pay royalties. MedImmune continued to pay royalties to Genentech under protest and filed a declaratory judgment action.

Justice Thomas, in his lone dissent, held that the federal courts lacked jurisdiction over the case because MedImmune had not raised a viable case or controversy. The question, as Justice Thomas put it, was hypothetical. The licensee was asking, in effect, “If I decide not to pay royalties and the licensor sues me, would I win?” In Justice Thomas’s view, the courts should not issue what amounted to an advisory opinion. *Id.* at 780 (Thomas, J., dissenting).

The Court’s majority framed the question differently. It said that there was a justiciable dispute as to the parties’ rights and obligations under the license agreement. The Court analogized the situation to cases in which a party has challenged a statute or regulation under threat of sanction; in certain circumstances, the courts have held that a party need not commit a violation and risk the sanction in order to raise a justiciable challenge. According to the Court, MedImmune faced the same conundrum. Although the previous cases involved a threat from a government agency, not a commercial enterprise, in the Court’s view the jurisdictional issue did not turn on the party’s identity. *Id.* at 772-73.

One interesting aspect of the Court’s decision is its treatment of Genentech’s argument that a license agreement is like a settlement agreement or an insurance contract: a licensor agrees not to file a lawsuit, and immunizes the licensee from liability, so long as the licensee pays royalties. According to Genentech’s argument, it is inconsistent with the terms of the parties’ bargain to allow a licensee to continue to reap the benefits of the license by paying royalties (*i.e.*, to immunize itself from an infringement suit) and to challenge the licensor’s patent at the same time. Put another way, the licensee’s option is to comply with the license or do battle; the licensee can’t have it both ways.

The Court brushed that argument aside. “To begin with, it is not clear where [in the license agreement] the prohibition against challenging the validity of the patents is to be found. . . . Promising to pay royalties on patents that have not been held invalid does not amount to a promise *not to seek* a holding of their invalidity.” *Id.* at 776. This response to Genentech’s position appears to turn on the terms of the license agreement, and not on any overarching principle of federal jurisdiction. In other words, the particular agreement in this case did not support the premise of Genentech’s argument, so the argument failed.

But what if a license agreement contained the necessary promise? Could a license be drafted with an enforceable provision that bypasses *MedImmune* and precludes the licensee from paying royalties under protest and bringing a declaratory judgment action? One can imagine down the road complex cases in which the courts have to grapple with the interplay of jurisdictional principles, contract terms, and patent law to decide disputes between licensees and licensors who have incorporated creative litigation terms into their agreements. How these decisions will fare under *MedImmune* is yet another open question.

**Conclusion.** In sum, the Supreme Court’s three patent cases this term have raised a number of interesting issues that lower courts will be left to decide. The broadest and most far-reaching decision – *KSR* – left the door partially open to further application of the prevailing obviousness test, albeit in a more moderate form than the Federal Circuit had applied in that case. *Microsoft* and *MedImmune* raise questions as to how they will be applied in other factual contexts. In the end, what appeared to be a significant development – Supreme Court review and reversal of three Federal Circuit decisions in one term – may well end up being a mere footnote.