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General: In determining a RAND royalty rate for a patent essential to the implementation of an industry standard, a court may consider a hypothetical bilateral negotiation under the obligations of the RAND commitment and that patent's importance to both the standard and resulting products.

Microsoft Corp. v. Motorola Mobility, Inc.

No. 10-cv-01823-JLR Findings of Fact and Conclusions of Law (W.D. Wash.)

April 25, 2013

I. Facts

Motorola Mobility, Inc. (“Motorola”) offered to license Microsoft Corp. (“Microsoft”) its patents essential to the implementation of two standards. The standards at issue involve an the Institute of Electrical Electronics Engineers (“IEEE”) wireless local area network standard called the “802.11 standard” and an International Telecommunication Union (“ITU”) advanced video coding technology standard called the “H.264 standard.” Motorola voluntarily committed its patents to the standards setting organizations (“SSOs”) developing the 802.11 standard and the H.264 standard, thereby agreeing to license the technology on reasonable and non-discriminatory (“RAND”) terms according to contractual provisions governing the SSO members. A disagreement arose over the royalty calculation that Motorola proposed. Therefore, Microsoft filed this present breach of contract claim against Motorola.

Microsoft claimed that Motorola breached its RAND obligation to the IEEE and ITU by making an unreasonable offer in a negotiation to license Motorola’s 802.11 and H.264 standard essential patents (“SEPs”). Microsoft contended that the economic value of patented technology isolated from the value derived from incorporation into the standard would be determined by calculating the incremental value of the technology compared to the alternatives that could have been written into the standard. Thus, Microsoft argued, the focus should be on the period before the standard was adopted and implemented. In support of its arguments, Microsoft submitted comparable rates based on other license agreements. Microsoft’s submissions were based mainly on the rates set by two existing patent pools¹, namely MPEG-LA for H.264 and the Via Licensing pool for 802.11.

¹ A patent pool consists of a group of patent owners that have agreed to cross-license their patents relating to a particular technology.

Motorola, on the other hand, argued that RAND terms and conditions can be determined by simulating a hypothetical bilateral negotiation under the RAND obligation. To assist the court in determining the actual rates, Motorola submitted comparable licensing rates based on prior licensing arrangements with various parties that it contended supported its asserted rate of 2.25% of the end-product price.

The procedural history of this case further explains the findings of fact and conclusions of law. In a previous order, the court held that Microsoft – as a standard-user – can enforce contracts between SEP holders and SSOs as a third-party beneficiary. The previous order also interpreted Motorola’s commitments to the ITU and IEEE as requiring initial offers by Motorola to license its SEPs to be reasonable. However, the court determined that before it could find whether or not Motorola’s licensing offers had breached Motorola’s commitments to the IEEE and ITU, the court would have to determine the actual RAND licensing rate and RAND royalty range with respect to Motorola’s SEPs for the 802.11 and H.264 standards.

II. Issues

- A. How should a court determine RAND terms and conditions for patents essential to industry standards?
- B. Was Motorola’s offer to license its patents a violation of its RAND commitment to SSOs?

III. Discussion

- A. The court first sets out to define the RAND obligation, then vets the *Georgia-Pacific*² factors and their applicability to establishing a RAND royalty, and finally, applies the factors in modified form to the facts of the case.

In setting forth the basic principles at issue, the court explained that “a RAND commitment should be interpreted to limit a patent holder to a reasonable royalty on the economic value of its patented technology itself, apart from the value associated with incorporation of the patented technology into the standard.”

With regard to the royalty calculation, the court looked at the well-known *Georgia-Pacific* analysis³. The court focused on a select few of the 15 *Georgia-Pacific* factors in its rate-setting discussion. The *Georgia-Pacific* factors traditionally assume a hypothetical negotiation between the patent holder and accused infringer just before the alleged infringement began. The court’s opinion, however, modified the *Georgia-Pacific* factors to

² *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

³ The *Georgia-Pacific* analysis is one methodology the Federal Circuit has outlined for determining “reasonable royalty” damages in patent infringement actions.

provide a useful framework for future RAND royalty disputes because typical patent holders are not obligated to license their patents.

Factor 1 (the royalties received by the patentee for licensing the patents at issue) must be modified to only consider royalties paid by licensees under RAND licensing conditions. Both license agreements, where the parties clearly understood the RAND obligation, and patent pools will be relevant to a hypothetical negotiation for SEPs. Although patent pools produce lower royalty rates than those achieved in most bilateral negotiations, patent pools can serve as indicators of a royalty rate that falls within the range consistent with the RAND commitment.

Under Factor 2, the court looked at other rates paid by the licensee to use comparable patents. Any empirical evidence of other royalty rates that are offered to inform the royalty determination should also be a RAND royalty or comparable.

Factors 4 and 5 (the licensor's policy and program of not licensing to others and the relationship between licensor and licensee, including whether they are competitors) are disregarded in a RAND analysis.

Factors 6 and 8 (the effect of selling the patented specialty in promoting sales of other products of the licensee and the established profitability of the products made under the patent) have to be adjusted to factor out any value that arises solely from the patent's potential hold-up⁴ power as a result of being included in the standard. Here, the court's analysis focused on the value of the patented technology apart from the value associated with incorporation of the patented technology into the standard and the contribution of the patented technology to the standard.

Factor 7 (duration of patent and term of license) is simplified because the license is assumed to extend for the duration of the patent.

Factor 9 considers the utility and advantages of the patent property over the old modes or devices. Through this factor, the hypothetical negotiation under the RAND commitment would consider alternatives that could have been written into the standard instead of the patented technology.

Factors 10 and 11 (benefits to those who use the invention and value of use to the infringer) must be focused on the contribution of the patent to the technical capabilities of the standard and to the licensee's products.

Factor 12 (portions of the profit or selling price that are customary for use of the invention) must be focused on what is customary in RAND-licensing situations.

⁴ Patent hold-up refers to the ability of a holder of an SEP to demand more than the value of its patented technology and to attempt to capture the value of the standard itself.

Under Factor 13, the court considered the portion of the profit that should be credited to the invention itself as a result of significant features or improvements added by the invention. It is critical to consider the contribution of the patented technology apart from the value of the patent as the result of its incorporation into the standard.

Finally, under Factor 15, the court considered the amount that a licensor and a licensee would have agreed upon at the time infringement began if both had been reasonably and voluntarily trying to reach an agreement. The SEP owner would have been obligated to license its SEPs on RAND terms which necessarily must abide by the purpose of the RAND commitment of widespread adoption of the standard through avoidance of hold-up and stacking⁵. With respect to hold-up, the parties would examine a reasonable royalty rate based on the contribution of the patented technology to the capabilities of the standard, and in turn, the contribution of those capabilities of the standard to the implementer and the implementer's products. With respect to stacking concerns, the parties attempting to reach an agreement would consider the overall licensing landscape in existence in relation to the standard and the implementer's products.

- B. Yes. The court applied its modified *Georgia-Pacific* factors to the facts of the case, calculating a reasonable royalty which represented only a small fraction of the amount sought by Motorola and finding that the rates proposed in the original offers were unreasonable.

First, the court discussed modified Factor 15. The court examined Motorola's H.264 and 802.11 patent portfolios to determine each portfolio's importance to its respective standard as well as the importance to Microsoft's products. It found that several of Motorola's patents provided only a minimal contribution to the standards and played only a minor role in the overall functionality of some of Microsoft's products.

For example, 92 other entities also claimed to have SEPs for the 802.11 standard. 52 other entities claimed to have H.264 SEPs. In the event that each of these entities was allowed to collect royalties at the level proposed by Motorola, the royalties per product would create a patent stacking issue. According to the court, this result would be contrary to the purpose of promoting wide-spread adoption of the standard. In so holding, the court found that the particular value of the Motorola patents was minimal and not entitled to a royalty rate beyond that which may be expected from any of the other entities that contributed patented technology to the standard.

⁵ Patent stacking refers to the payment of excessive royalties to many different holders of SEPs, which can result in cumulative royalty payments that undermine the adoption of the standards.

Next, the court examined modified Factor 2. The court analyzed the comparable rates offered as evidence by both parties. Evidence offered by Motorola consisted of licenses with third parties that included licenses to H.264 and 802.11 SEPs. The court decided that Motorola's previous licenses with VTech, RIM, and Symbol Technologies were not comparable licenses because they (i) were executed as part of a settlement to resolve litigation that did not relate to the relevant standards or SEPs, (ii) failed to allocate royalties to the relevant SEPs or (iii) covered expired patents. Microsoft, on the other hand, provided evidence of low royalty rates in comparable patent pools. While noting certain differences between the dynamics of a patent pool and a bilateral negotiation under its proposed modified *Georgia-Pacific* factors, the court nonetheless concluded that "the characteristics of the MPEG-LA H.264 pool closely align with all of the purposes of the RAND commitment," and that the Via Licensing 802.11 patent pool at least "has certain characteristics that are indicative of a RAND royalty rate."

The court identified at least three problems with using patent pool rates as comparables for the purpose of calculating a RAND rate. First, patent pool rates tend to be lower than rates agreed upon in actual bilateral negotiations. Second, patent pools tend to allocate royalties among patent holders based purely on the number of patents that each party has included, leaving aside any qualitative analysis of the patents in the patent pools. Third, patent pools do not examine the incremental value of the patents in the pools compared to other available alternatives prior to the establishment of the standard at issue. Nevertheless, the court adopted Microsoft's comparables over those submitted by Motorola. Therefore, the courts used the MPEG-LA H.264 patent pool and the Via Licensing 802.11 patent pool as guideposts to determine the RAND rate and range for each set of SEPs.

In order to determine the RAND rate and range for Motorola's H.264 patents, the court looked at how much parties in a RAND negotiation would pay before the standard became cost-prohibitive. Therefore, the court determined a maximum amount by looking to the highest fee discussed during the formation of the MPEG-LA H.264 patent pool. The court determined that Motorola would be entitled to 5.463 cents per unit under such an arrangement, then added an additional two times that value to determine the upper limit of the RAND range – 16.389 cents per unit. Thus, the court found that the appropriate RAND range for Motorola's H.264 SEPs was between 0.555 cents per unit and 16.389 cents per unit, with the actual rate at the bottom end of this range because Motorola did not provide evidence that its patents were of particular value to the standard.

To obtain a RAND rate for Motorola's 802.11 patents, the court decided to determine the average of three indicators: (i) a 6.114 cent figure suggested by the Via Licensing 802.11 patent pool; (ii) 3.5 cents per unit reported by Marvell, a third-party chipset provider who paid a 1% royalty rate for the licenses necessary to make its 802.11-compliant semiconductor chips; and (iii) 0.8 cents per unit to represent a low end of the analysis performed by InteCap, a consulting firm who proposed a licensing model to Motorola on the assumption that Motorola owned 25% of all 802.11 SEPs. Averaging these rates, the court found that the proper RAND rate for Motorola's patents regarding the 802.11 standard is 3.471 cents per unit.

To obtain a RAND range for Motorola's 802.11 patents, the court used the high point of the royalty range offered by Microsoft at the trial, 6.5 cents per unit, to derive the ceiling because it was similar to a number that could have been put forth in negotiations between the parties. Since the 6.5 cents per unit figure was based on Motorola's hypothetical participation in the Via Licensing 802.11 patent pool, the court multiplied it by three to reflect the added value to Motorola of patent pool participation for a final amount of 19.5 cents per unit. The court then set the bottom of the RAND range at 0.8 cents per unit, which was the lowest rate on the record based upon a methodology that the court had found to be an indicator of RAND.

The court found the RAND royalty range for Motorola's H.264 patent portfolio to span from 0.555 cents per unit to 16.389, with the patents at issue having a royalty rate of 0.555 cents per unit. The court also found the RAND royalty range for Motorola's 802.11 patents to span from 0.8 cents per unit to 19.5 cents per unit, with the patents at issue having a royalty rate of 3.471 cents per unit.

IV. Conclusion

This is the first judicial calculation of a RAND royalty rate. The court's analysis developed a new framework based on the modification of the *Georgia-Pacific* factors. Other judicial analyses under *Georgia-Pacific* remain relevant, but several factors are now modified for SEPs.

The application of this case may not always be licensee-favorable. *Microsoft v. Motorola* presented substantial and potentially unique evidence, for instance, of patent pools relating to the standards at issue, that the SEPs at issue were not particularly valuable as compared to other patents essential to the standards, and of similar valuation analyses commissioned by the patent holder.

Although this case is precedential only in the Western District of Washington, it provides a valuable roadmap and will probably influence courts in other U.S. and international jurisdictions deciding future RAND cases (if upheld upon appeal).