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KEY IDEAS:

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RAND ROYALTIES REVIVED
DOES *MICROSOFT* REPRESENT A "*GEORGIA-PACIFIC*" TEST FOR PATENT ROYALTIES? (PART II)

RAND royalties got a shot of adrenaline in the epic *Microsoft Corp. v. Motorola, Inc.* opinion.[1] Culminating years of litigation, Microsoft outlines a thoughtful and important methodology for determining RAND royalty obligations when owners of SEPs and implementers cannot agree on RAND royalty terms. If adopted by other courts, the Microsoft methodology may serve as the "Georgia-Pacific" test for RAND licenses.

Last month, we analyzed the basics of RAND royalties.[2] This month, we take a deep dive into the *Microsoft* court's modified *Georgia-Pacific* analysis.

Procedural Background of *Microsoft Corp. v. Motorola, Inc.*

The procedural background of this complex case provides important context:

- Microsoft and Motorola are members of two Standards Setting Organizations (SSOs): the IEEE (the Institute of Electrical Electronics Engineers) and the ITU (the International Telecommunication Union). Motorola is the owner of several SEPs (Standard Essential Patents) for standards established by the IEEE and the ITU. Motorola filed materials with each SSO, assuring that it would license the SEPs to any applicant on RAND terms.[3]
- Motorola offered to license the SEPs to Microsoft for 2.25 percent, a rate Microsoft found unreasonable.[4]
- Microsoft then sued Motorola, alleging that Motorola breached its obligation to Microsoft to license SEPs at a RAND rate.[5] Motorola subsequently sued Microsoft for patent infringement, and the two cases were consolidated.[6]
- Ruling on Microsoft's motion for summary judgment, the court determined that (1) Motorola entered into binding contractual commitments with the SSOs to license its SEPs on RAND terms and conditions, and (2) Microsoft was a third-party beneficiary of those contractual commitments.[7] In a later ruling affirming the district court's grant of an anti-suit injunction related to a German action between Microsoft and Motorola, the Ninth Circuit also concluded that Microsoft has an enforceable legal right to a RAND license from Motorola.[8]

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1 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013).

2 For additional background on RAND licenses, see the May 2013 issue of *IpQ* online at http://www.shb.com/newsletters/IpQ/IpQ.5.5.pdf.

3 *Microsoft Corp.*, 2013 WL 2111217, at *1.

4 *Id.* at *2.

5 *Id.* at *1.

6 *See Microsoft Corp. v. Motorola, Inc.*, No. 854 F. Supp. 2d 993, 996 (W.D. Wash. 2012).

7 *Id.* at 1002.

8 *Microsoft Corp. v. Motorola, Inc.*, No. 696 F.3d 872, 885 (9th Cir. W.D. Wash. 2012); *See Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 WL 4827743, at *6 (W.D. Wash. Oct. 10, 2012).

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... the court (1) introduced the parties; (2) provided background information on standards, SSOs and the RAND commitment; (3) developed an analytical framework for assessing RAND terms; (4) analyzed one standard; (5) analyzed the other standard; and (6) concluded by setting an appropriate RAND rate and range.

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- Mitigate "Hold Ups" ...
- Address "Stacking" Risk ...
- Value Patent Only ...

- The district court also decided that initial offers need not be on RAND terms as long as a RAND license ultimately issues. Initial offers, however, must comport with the implied duty of good faith and fair dealing inherent in every contract.[9] The district court concluded that, before it could determine whether Motorola had breached the terms of its contractual obligations of good faith and fair dealing by offering an unreasonable license rate, it had to determine appropriate RAND terms for an agreement between Microsoft and Motorola for Motorola's SEPs.[10]
- In denying later cross-motions for summary judgment on Microsoft's breach of contract claim, the court observed, "Having made the determination that Motorola must grant a RAND license for its essential patents, the court is left with the inescapable conclusion that a forum must exist to resolve honest disputes between the patent holder and implementer as to what in fact constitutes a RAND license agreement." The court concluded that the courthouse might be the only such viable forum.[11]
- The parties agreed to a bench trial to determine the RAND royalty rate.[12] The bench trial would determine a RAND royalty rate and RAND royalty range for Motorola's SEPs, enabling a fact finder in a later trial to determine whether Motorola's offers to Microsoft were made in good faith.[13]

Analytical Methodology

After the bench trial, the court employed a six-step approach to determine the RAND rate and range. In its thorough opinion, the court (1) introduced the parties; (2) provided background information on standards, SSOs and the RAND commitment; (3) developed an analytical framework for assessing RAND terms; (4) analyzed one standard; (5) analyzed the other standard; and (6) concluded by setting an appropriate RAND rate and range.[14]

Basic Principles

Before outlining its specific methodology for assessing RAND licenses, the court announced four basic principles:

- **Widespread Adoption** – The RAND royalty should be set at a level consistent with promoting widespread adoption.[15]
- **Mitigate "Hold Ups"** – The methodology employed should mitigate the risk of patent "hold ups" where the owner of an SEP demands both the value of the patented technology *and* the considerable value of the standard.[16]
- **Address "Stacking" Risk** – The methodology should address the risk of royalty stacking by considering aggregate royalties if other SEP holders make royalty demands.[17]
- **Value Patent Only** – Importantly, the methodology has to limit the patent owner to the economic value of the patent, apart from significant value associated with the patent's incorporation into the standard.[18]

Modified *Georgia-Pacific* Hypothetical Negotiation

The court tested the parties' suggested methodologies using these basic principles. Microsoft proposed an *ex ante* analysis of the incremental value of the SEP compared to alternatives that

9 *Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1038 (W.D. Wash. 2012).
10 *Id.*
11 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 WL 4827743, at *6 (W.D. Wash. Oct. 10, 2012).
12 *Id.*
13 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at *3 (W.D. Wash. Apr. 25, 2013).
14 *Id.* The first two steps were discussed in the May 2013 issue of *IpQ*.
15 *Id.* at *12.
16 *Id.*
17 *Id.*
18 *Id.*

could have been written into the standard,[19] while Motorola proposed hypothetical bilateral negotiations.[20]

While recognizing value in analyzing the incremental contribution of the patented technology to the standard under the *ex ante* approach,[21] the court found support for the hypothetical negotiation based on courts' long-time acceptance and application of the *Georgia-Pacific* factors.[22] The court decided, however, that "the following *Georgia-Pacific* factors must be modified,"[23] specifically discussing 12 of the 15 factors:

- **Factor 1 (Established Royalty)** – To prove an established royalty for an SEP, the past royalty rates must have been negotiated under the RAND obligation or in a comparable context.[24]
- **Factor 4 (Licensor's Marketing Policy)** – This factor, under which courts ordinarily consider an owner's policy to protect the patent as a monopoly, is inapplicable. The SEP owner's commitment to license on RAND terms simply eliminates any ability to maintain the patent monopoly.[25]
- **Factor 5 (Commercial Relationship)** – The parties' competitive relationship is not relevant in the RAND context. Having committed to RAND terms, the SEP owner cannot discriminate against competitors.[26]
- **Factors 6 and 8 (Effect of Patent on Sales of Licensor and Licensee), Factors 10 and 11 (Character and Use of Invention), and Factor 13 (Value Contribution)** – The focus is on the value of the patented technology rather than the value associated with the patent as part of the standard. Thus, the patent's contribution to the technical capabilities of the standard, the implementer and the implementer's products must be considered separate from the value derived from incorporation into the standard.[27]
- **Factor 7 (Patent Term)** – In the RAND context, the license term is equal to the patent term. This factor will generally have little influence on the RAND license negotiation.[28]
- **Factor 9 (Patent Advantages)** – Parties to a RAND negotiation would consider alternatives that could have been written into the standard. This, in part, recognizes Microsoft's proposed incremental *ex ante* analysis.[29]
- **Factor 12 (Customary License)** – Logically, this factor has to be viewed through the lens of business practices involving RAND commitments, not licensing fees for non-RAND committed patents.[30]
- **Factor 15 (Hypothetical Negotiation)** – The RAND commitment and obligations must be considered as part of the hypothetical negotiation.[31]
- **"Hold Up"** – Parties would consider the contribution of the patented technology to the capabilities of the standard and, in turn, the contribution of those capabilities to the implementer and the implementer's products. A patent that contributes a great deal to the standard will have a higher royalty rate than a patent to a standard's optional feature that an implementer may not use.[32]

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19 *Id.* at *13-*14.
20 *Id.* at *14.
21 *Id.* at *13.
22 *Id.* at *15 (citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).
23 *Id.* at *18.
24 *Id.*
25 *Id.*
26 *Id.*
27 *Id.* at *18, *19.
28 *Id.* at *19.
29 *Id.*
30 *Id.*
31 *Id.* at *20.
32 *Id.*

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- **"Stacking"** – A RAND negotiation is not conducted in a vacuum. The parties would consider other SEP holders and the royalty rate each might seek based on the importance of those patents to the standard and the implementer's products.[33]
- **"Reasonable Royalty"** – Finally, the RAND commitment must guarantee that SEP owners will receive a reasonable royalty.[34]

New Test Applied

Having developed the new methodology, the court applied it to the case at hand. In the remainder of its lengthy opinion, the court analyzed (1) the importance of Motorola's SEP to the applicable standards,35 (2) the importance of Motorola's SEP to Microsoft's accused products,36 (3) comparable licenses,37 (4) comparable patent pools,38 and (5) a valuation model.39 Based on its deep analysis, the court calculated the appropriate RAND royalty range and rate (from .555 to 16.389 cents per unit depending on the standard and the product) for licenses for the accused Microsoft products under the Motorola SEPs.40

Microsoft Corp. v. Motorola, Inc. In Use

In a subsequent case, *Realtek Semiconductor Corp. v. LSI Corp.,*[41] LSI owned an SEP for an IEEE standard and submitted documents assuring that it would license all applicants on RAND terms.[42] Before offering Realtek a license to the SEP, LSI filed a complaint with the International Trade Commission (ITC), alleging infringement of its SEP and seeking an order to exclude the accused Realtek products from entering the United States.[43]

Realtek immediately brought suit against LSI in district court. It (1) filed a motion for partial summary judgment, claiming that LSI breached its RAND obligations to Realtek; and (2) sought a preliminary injunction barring LSI from enforcing any exclusion order entered by the ITC.[44] Relying on the court's opinions in *Microsoft,* the district court decided that (1) LSI was contractually obligated to license the SEP to Realtek on RAND terms; (2) LSI breached the contract when it sought injunctive relief at the ITC before offering Realtek a license; and (3) it would grant Realtek's motion enjoining LSI from enforcing any exclusionary order issued by the ITC.[45] The court also denied LSI's motion to stay the suit pending resolution of the ITC proceeding.[46]

Conclusions

With an appeal a virtual certainty, it will be interesting to see what the Federal Circuit does with the methodology adopted by the *Microsoft Corp. v. Motorola, Inc.* court. We may be witnessing the birth of the "*Georgia-Pacific*" of RAND license royalties.

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33 *Id.*
34 *Id.*
35 *Id.* at * 21-*42, *49-*54.
36 *Id.* at *42-*49, *54-*64.
37 *Id.* at *65-*74, *93-*95.
38 *Id.* at *74-*92.
39 *Id.* at *95-*98.
40 *Id.* at *98-*101.
41 No. C-12-03451, 2013 WL 2181717 (N.D. Cal. May 20, 2013).
42 *Id.* at *1.
43 *Id.* at *2.
44 *Id.* at *3.
45 *Id.* at *7, *10.
46 *Id.*