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RAND ROYALTIES REFRESHED  
A PRIMER FOR A MODIFIED GEORGIA-PACIFIC  
PATENT ROYALTIES TEST? (PART I)

RAND royalties are retaking center stage as a standards rule. In a 200-plus-page opinion tackling SSOs, SEPs, and RAND obligations, the district court judge in *Microsoft Corp. v. Motorola, Inc.* outlined a modified *Georgia Pacific* methodology for calculating RAND royalty obligations.<sup>1</sup>

A Reasonable and Nondiscriminatory (RAND) royalty comes into play when the owner of a Standard Essential Patent (SEP) and a potential implementer/user of the standard negotiate a RAND license. If the parties cannot agree on a royalty, the district court may step in to resolve the issue.<sup>2</sup> If adopted by other courts, the *Microsoft* court’s methodology may serve as the “*Georgia-Pacific*” of RAND licenses, setting a new “standard” for determining royalties associated with such licenses.

Understanding SSOs, SEPs, RAND, FRAND,<sup>3</sup> and how they affect remedies available to or recoverable from your clients, is critical for every IP lawyer. This month, we review terminology, benefits, risks, and issues associated with RAND royalties. Next month, we will closely examine the *Microsoft* opinion and dissect the RAND royalty methodology the court used.

Standards

We live in a world of standards. There are standards for food, pharmaceuticals, automobiles, cell phones, computers, the Internet, and so on. Our IP focus is on technical standards, often established through intricate specifications—“an explicit set of requirements to be satisfied by a material, product, system, or service.”<sup>4</sup> Technical standards typically relate to safety (think FDA) or product and system interfaces (think electrical wall plugs, light bulb sockets, railroad tracks, and computer USB ports).

Standard-Setting Organizations

Standard-setting organizations (SSOs) are voluntary membership organizations whose participants develop standards for industries such as telecommunications and information technology.<sup>5</sup> Familiar examples of SSOs include the International Organization for Standardization (ISO); International Electrotechnical Commission (IEC); Institute of Electrical Electronics Engineers (IEEE); International Telecommunication Union (ITU); and World Wide Web Consortium (W3C). The IEEE and ITU are SSOs related to *Microsoft Corp. v. Motorola, Inc.*

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1 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013).  
 2 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 WL 4827743, at \*6 (W.D. Wash. Oct. 10, 2012).  
 3 *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 877 n.2 (9th Cir. W.D. Wash. 2012) (“Instead of RAND, some courts and commentators use the alternative, legally equivalent abbreviation ‘FRAND,’ for ‘fair, reasonable, and non-discriminatory rates.’”).  
 4 FORM AND STYLE FOR ASTM STANDARDS, at vii (Am. Soc’y for Testing and Materials Int’l, March 2013)  
 5 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at \*5 (W.D. Wash. Apr. 25, 2013).

As the U.S. Supreme Court observed, “[a]greement on a product standard is, after all, implicitly an agreement not to manufacture, distribute, or purchase certain types of products. Accordingly, private standard-setting associations have traditionally been objects of antitrust scrutiny.”

An attempt by an SEP owner to charge a license fee capturing both the value of the patented technology and the considerable value of the standard is referred to as a patent “hold up.”

## Benefits and Risks of Standards

SSOs allow competitors in the same industry to agree on common technical standards so that standard-compliant products can work harmoniously, reducing costs and increasing price competition by minimizing switching costs for consumers. SSOs promote widespread adoption of their standards by incorporating technology that is attractive and cost-effective for companies adopting their standard.<sup>6</sup>

SSOs, however, have a dark side. “There is no doubt that the members of such [standards-setting] associations often have economic incentives to restrain competition and that the product standards set by such associations have a serious potential for anticompetitive harm.”<sup>7</sup> Fundamentally, standards set by SSOs are agreements between competitors and may restrain trade. Such horizontal arrangements are often considered *per se* antitrust violations.<sup>8</sup> As the U.S. Supreme Court observed, “[a]greement on a product standard is, after all, implicitly an agreement not to manufacture, distribute, or purchase certain types of products. Accordingly, private standard-setting associations have traditionally been objects of antitrust scrutiny.”<sup>9</sup>

## Patents and Standards—Benefits and Risks

Obviously, industry participants in SSOs enjoy significant benefits if their technology becomes incorporated into a standard. Such benefits include increased demand for their products, the potential for shorter development lead times, and improved compatibility with proprietary products from competitors using the standard.<sup>10</sup> Although much of the technology incorporated into industry standards is not patented, a standard frequently requires use of patented technology.<sup>11</sup> Logically, if a standard includes patented technology, it entitles the patent owner to seek license fees from every manufacturer that incorporates the standard.

An SEP is a patent necessary to implement either a mandatory or optional provision of a standard.<sup>12</sup> Risks attendant with an SEP are self-evident. The owner of a widely used SEP has substantial leverage to demand more than the value of the patented technology.<sup>13</sup> This is true even if noninfringing alternatives to the patented technology were available at the time the standard was adopted.<sup>14</sup>

According to the Third Circuit, “Industry participants who have invested significant resources developing products and technologies that conform to the standards will find it prohibitively expensive to abandon their investment and switch to another standard. They will have become ‘locked in’ to the standard. In this unique position of bargaining power, the patent holder may be able to extract supracompetitive royalties from the industry participants.”<sup>15</sup>

**“Hold Ups”** – An attempt by an SEP owner to charge a license fee capturing both the value of the patented technology *and* the considerable value of the standard is referred to as a patent “hold up.”<sup>16</sup> Increased costs associated with a “hold up” may be passed along to consumers in the form of higher prices.<sup>17</sup>

**“Royalty Stacking”** – The risk of a “hold up” is compounded when a large number of SEP licenses lead to “royalty stacking.”<sup>18</sup> Complex industry standards may require the

6 *Id.*

7 *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500 (1988).

8 For example, price fixing is a horizontal restraint of trade and a *per se* antitrust violation.

9 *Allied Tube & Conduit Corp.*, 486 U.S. at 500.

10 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at \*5 (W.D. Wash. Apr. 25, 2013).

11 *Id.* at \*6, \*1.

12 *Id.*

13 *Id.* at \*9.

14 *Id.* at \*10.

15 *Broadcom Corp. v. Qualcomm Inc.*, 510 F.3d 297, 310 (3d Cir. 2007).

16 *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at \*10 (W.D. Wash. Apr. 25, 2013).

17 *Id.*

18 *Id.* at \*11.

ITU/IOS/EEC policy prohibits use of a patent in a standard when the owner declines to make a licensing commitment.

Neither the ITU nor the IEEE define or explain RAND licensing terms and conditions, nor do they attempt to determine what constitutes a reasonable royalty rate or what other terms and conditions are reasonable or nondiscriminatory for a license.

use of hundreds or even thousands of SEPs held by dozens of patent holders for a single product.<sup>19</sup> For example, a typical personal computer may involve as many as 90 formal standards and more than 100 informal interoperability standards.<sup>20</sup> Obviously, if hundreds or even thousands of SEPs relate to the standards applicable to a single product, not every patent owner can be entitled to a 1 percent royalty or even a 0.1 percent royalty.

### Solutions to Hold Ups and Royalty Stacking

To avoid the risks of patent “hold ups” and “royalty stacking,” while at the same time avoiding antitrust entanglements, SSOs have implemented key policies:<sup>21</sup>

- **Disclosure** – Policies of some SSOs, such as the ITU and ISO/IEC, encourage owners of potentially applicable SEPs to disclose such patents “as early as possible.”<sup>22</sup> The IEEE makes disclosure of specific patents optional, but allows a “blanket” disclosure of all patents that may be SEPs.<sup>23</sup> Failure to disclose a potential SEP to an SSO may constitute fraudulent or unfair activity and may subject assertion of the patent to various defenses.<sup>24</sup>
- **Licensing Commitment** – SSOs generally require SEP owners to commit to allow all potential users to (1) license the patent on a royalty-free basis or not enforce the patent at all, (2) license the patent on RAND terms and conditions, or (3) decline to make a licensing commitment.<sup>25</sup> ITU/IOS/EEC policy prohibits use of a patent in a standard when the owner declines to make a licensing commitment.<sup>26</sup> A patent owner making a commitment to license may do so subject to a condition of “reciprocity,” meaning the patent owner is only required to license the SEP if the licensee commits to license its SEPs for the same standard free of charge or under reasonable terms and conditions.<sup>27</sup>
- **Fair, Reasonable and Non-Discriminatory (FRAND or RAND) Royalty Rates** – Neither the ITU nor the IEEE define or explain RAND licensing terms and conditions, nor do they attempt to determine what constitutes a reasonable royalty rate or what other terms and conditions are reasonable or nondiscriminatory for a license.<sup>28</sup> The decision not to set license fees is borne from antitrust concerns. Thus, ITU/IOS/EEC policy leaves licensing arrangements for SEPs to the affected parties.<sup>29</sup>

### Open Issues

RAND royalties create interesting issues relating to jurisdiction and remedies in patent infringement cases.

**Jurisdiction** – The discussion of a RAND royalty occurs in the context of a negotiation for a contractual patent license between the SEP owner and the putative implementer/user. In *Microsoft Corp. v. Motorola, Inc.*, for example, Microsoft filed suit for breach of contract while Motorola separately sued for patent infringement.<sup>30</sup> The cases were consolidated, making

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> See *id.* at \*11.

<sup>22</sup> *Id.* at \*7.

<sup>23</sup> *Id.* at \*9.

<sup>24</sup> See *Rambus Inc. v. Infineon Techs. AG*, 318 F.3d 1081 (Fed. Cir. 2003); *Wang Labs., Inc. v. Mitsubishi Elec. Am., Inc.*, 103 F.3d 1571 (Fed. Cir. 1997).

<sup>25</sup> See *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217, at \*7 (W.D. Wash. Apr. 25, 2013).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at \*8.

<sup>28</sup> *Id.* at \*10.

<sup>29</sup> *Id.* at \*7.

<sup>30</sup> See *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp. 2d 993, 996 (W.D. Wash. 2012).

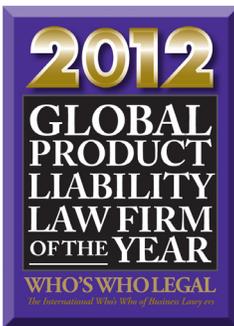
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jurisdiction under 28 U.S.C. §1338(a) appropriate.

In light of the U.S. Supreme Court's decision in *Gunn v. Minton*,<sup>31</sup> if the action is merely for breach of the contractual commitment by the SEP owner to enter into a RAND license, the party seeking federal jurisdiction will need to argue that the case involves a "substantial" issue of importance to the federal system as a whole and not just the parties in suit to support federal court jurisdiction.<sup>32</sup>

**Injunctions** – The SEP owner will find it difficult or impossible to establish its right to injunctive relief. The U.S. Supreme Court's opinion in *eBay Inc. v. MercExchange, L.L.C.*,<sup>33</sup> requires a plaintiff to demonstrate, *inter alia*, (1) irreparable injury and (2) inadequate remedies at law. The availability of a RAND royalty seems to negate both of these critical elements for injunctive relief.<sup>34</sup>

In *Microsoft Corp. v. Motorola, Inc.*, the court granted Microsoft's motion for summary judgment, dismissing without prejudice Motorola's request for injunctive relief for patent infringement.<sup>35</sup> The court concluded that Microsoft was a third-party beneficiary of Motorola's commitments to the SSOs (IEEE and ITU) and was therefore entitled to a RAND license.<sup>36</sup> Since Microsoft had committed to accept a license on RAND terms for the SEPs, it was clear that a license agreement would become a reality. Royalties Microsoft would pay under the license were Motorola's remedy, thus Motorola had no irreparable harm. For similar reasons, the remedy would make Motorola whole and provide it an adequate remedy at law.<sup>37</sup>

Judge Richard Posner reached the same conclusion in *Apple, Inc. v. Motorola, Inc.*, stating that Motorola "implicitly acknowledged that a FRAND [RAND] royalty is adequate compensation for a license to use the patent" when it committed to license the technology to anyone willing to pay a FRAND [RAND] royalty.<sup>38</sup>

**Calculating RAND Damages** – Very few cases discuss calculating a RAND royalty. The court in *Microsoft Corp. v. Motorola, Inc.*, however, boldly described and implemented a modified *Georgia-Pacific* approach to the hypothetical negotiation to identify a RAND royalty and RAND royalty range.<sup>39</sup> In June's *IpQ*, we will delve into the court's potentially ground-breaking decision, and how it might influence your client's cases and your damages practice.

### SPECIAL NOTE: Check out *IpDamQuick*™

I recently launched a new blog, *IpDamQuick: Enhancing Your IP Damages IQ*®. You can register for a free subscription at <http://ipdamquick.com>.

Every week on *IPDamQuick* (or when there are valuable damages opinions), I offer top-line thinking about top-of-mind IP damages topics. *IPDQ* provides concise commentary on their immediate effect and their possible long-term impact.

Here's where you come in. If you see a recent patent damages opinion not appearing in my blog, please forward it to me at [pstrand@shb.com](mailto:pstrand@shb.com). I will include it immediately so that other practitioners can remain up to date on this rapidly evolving area of the law. Thanks, and I look forward to hearing from you.

No. C10-1823JLR, 2013 WL 2111217, at \*1 (W.D. Wash. Apr. 25, 2013); *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp. 2d 993, 1002 (W.D. Wash. 2012).

31 *Gunn v. Minton*, \_\_\_ U.S. \_\_\_, 133 S. Ct. 1059 (2012).

32 *See id.* at 1066, 1068.

33 547 U.S. 388, 391 (2006).

34 *See Atlanta Pharma AG v. Teva Pharma. USA, Inc.*, 566 F.3d 999, 1005 (Fed. Cir. 2009) (Movant must establish existence of first two factors [likelihood of success and irreparable harm] to be entitled to a preliminary injunction.) (emphasis added).

35 No. C10-1823JLR, 2012 WL 5993202, at \*8 (W.D. Wash. Nov. 30, 2012).

36 *Id.* at \*6.

37 *Id.*

38 2012 U.S. Dist. LEXIS 89960, 44-47 (N.D. Ill. June 22, 2012) (Posner, J. sitting by designation).

39 No. C10-1823JLR, 2013 WL 2111217, at \*16-\*20 (W.D. Wash. Apr. 25, 2013).