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On July 30 the Court of Appeals for the Ninth Circuit issued a significant appellate decision that provides guidance regarding obligations imposed on licensors of patents that are required to comply with interoperability standards, commonly referred to as standard-essential patents, or SEPs.[1] To reduce the risk that a SEP holder will try to extract more than the fair value of its SEPs patents, many standard setting organizations (SSOs) require their members to agree to license SEPs on fair, reasonable and non-discriminatory (RAND) terms.[2] In *Microsoft Corp. v. Motorola, Inc.*, the Ninth Circuit affirmed a Washington district court ruling that set forth a methodology for calculating a RAND royalty rate, the types of evidence necessary to determine whether RAND commitments have been breached, and the proper measure of damages for such breach.[3]

What does the *Microsoft-Motorola* decision mean?

The Ninth Circuit's decision in *Microsoft-Motorola* case represents the first instance in which a federal judge determined what the "fair, reasonable and non-discriminatory" standard means. The decision not only provides important insight into the methodology for determining RAND rates, it also explains the types of evidence necessary to determine whether RAND commitments have been breached and the proper measure of damages for such breach.

The court's decision is consistent with the emerging consensus, in the U.S. and abroad, that a patent owner subject to RAND commitments is generally precluded from seeking injunctive relief against a willing licensee. However, the Ninth Circuit noted that a RAND commitment would not preclude a patent owner from seeking injunctive relief if an infringer refuses to accept an offer on RAND terms.

The *Microsoft-Motorola* decision

Background: In October 2010, Microsoft sued Motorola in the U.S. International Trade Commission (ITC) and the Western District of Washington for alleged infringement of certain smartphone patents. After discussions for a cross-licensing agreement, Motorola sent Microsoft two letters offering to license its 802.11 and H.264 SEP portfolios at 2.25% of the price of the Microsoft end products incorporating the patents.[4] Motorola represented in both letters that the offer was in keeping with its RAND commitments.

After receiving the letters, Microsoft filed an action for breach of contract in the Western District of Washington, in which it alleged that Motorola had breached the RAND commitments set forth in its contracts with the IEEE and ITU. The next day Motorola filed suit against Microsoft in the Western District of Wisconsin, seeking to enjoin Microsoft from using the H.264 patents (this case was later consolidated with the action filed by Microsoft in Washington). Motorola also filed a patent enforcement action with the International Trade Commission and another action in Germany, seeking an injunction against sales of Microsoft's H.264-compliant products. To prevent economic loss that would result if an injunction against use of Motorola's two German H.264 patents were granted, Microsoft relocated its European distribution center from Germany to The Netherlands. It also obtained an anti-suit injunction from the Washington district court which barred Motorola from enforcing any injunction it might obtain in Germany until the Washington court determined if injunction was an appropriate remedy.

In a series of orders, the district court subsequently held that (1) the RAND commitments created enforceable contracts between Motorola and the respective SSO; (2) because Microsoft was a user of the standards, it could enforce these contracts as a third-party beneficiary; (3) Motorola's commitments to the IEEE and the ITU required that the initial offers by Motorola to license its SEPs be made in good faith; and (4) Motorola was not entitled to injunctive relief on its patents.

Bench trial: In November 2012, the district court conducted a bench trial to determine a RAND rate and range for Motorola's patents. The court reasoned that this determination was necessary, because "[w]ithout a clear understanding of what RAND means, it would be difficult or impossible to figure out if Motorola breached its obligation to license its patents on RAND terms." The court used the 15 factor test articulated in *Georgia-Pacific*

Corp. v. United States Plywood[5] to determine the royalty, but removed certain factors which it determined were contrary to RAND principles — for example, it removed factors aimed at preserving monopolies, which is contrary to the RAND purpose of preventing monopolies by making SEPs available to all licensees. In order to ensure that licensees are not paying a premium because the use of the technology is required to implement the standard, the court held that the royalties for SEPs should be based on hypothetical negotiations which occurred before the standard was adopted. The court also noted the need to avoid "royalty stacking," a situation where the combined royalty rate of multiple SEPS is more than the profit a licensee will receive for its product.

In April 2013, the court issued a ruling that set a RAND royalty for the Motorola patents with respect to Microsoft's alleged infringing products. The court concluded that the RAND royalty for Motorola's H.264 portfolio was .555 cents per end-product unit, with an upper bound of 16.389 cents per unit, and the rate for Motorola's 802.11 portfolio was 3.71 cents per unit, with a range of .8 cents to 19.5 cents. Both of these rates fell far below the 2.25% of the end unit selling price that Motorola requested in its offer letters to Microsoft.

Jury trial: The case proceeded to a jury trial on Microsoft's breach of contract claim. Over Motorola's objection, Microsoft was permitted to introduce the RAND rates determined at the bench trial through witness testimony. The jury returned a verdict for Microsoft in the amount of $14.52 million: $11.49 million, which represented the costs that Microsoft incurred as a result of its relocation of the distribution center from Germany to The Netherlands, and $3.03 million in attorneys' fees and litigation costs. No particular factors were deemed dispositive, but evidence of Motorola's course of conduct supported the verdict, including factors relating to Motorola's initial offer letters and Motorola's seeking injunctive relief.

Ninth Circuit decision: The Ninth Circuit affirmed the district court's determination of the RAND rate and range for each SEP portfolio and found that evidence supported the jury's verdict that Motorola breached its RAND commitment based on Motorola's injunction-related activity and overall course of conduct. The Ninth Circuit emphasized several factors supporting how the jury could infer that Motorola sought to capture more than the value of its patents by inducing holdup, and that it filed infringement actions in furtherance of that strategy, to prevent Microsoft from using its SEP portfolios until it obtained a license at a significantly higher rate than the RAND rate. The Ninth Circuit noted that a patentee subject to RAND commitments may have difficulty establishing irreparable harm required for injunctive relief since it is obligated to license the SEPs to all interested parties at RAND rates and therefore the payment of damages will generally be adequate compensation.

Recommendations for patent holders

We recommend that patent holders consider the following in the wake of the *Microsoft-Motorola* decision:

1. **Adopt a written policy governing employee participation in SSOs.** Patent holders should adopt and enforce a clearly written policy, reviewed by counsel, governing their employees' participation in SSOs.
2. **Review the SSO membership agreement before joining.** Because these membership agreements create contracts that can be enforced by the SSO, as well as users of the standards created by the SSO, companies should review these agreements carefully before they join the SSO.
3. **Think twice before deciding to make your technology part of an interoperability standard.** The *Microsoft-Motorola* decision can be viewed as favoring users of a standard over owners of the SEP, with the likely result that an SEP portfolio will be less valuable to a company that is seeking to enter into a cross-license with a third party holding a non-SEP patent portfolio.
4. **Patent holders should keep their RAND obligation in mind when offering to license SEPs.** Although the district court held that Motorola's initial offer to license did not have to be made on RAND terms as long as a RAND license eventually issued, it also noted that even the initial offer must be made in good faith.
5. **The Ninth Circuit's methodology for determining RAND rate is likely to be applied in future actions related to SEPs.** Although the 9th Circuit did not hold that the district court's methodology for setting the RAND rate was exclusive, the Georgia-Pacific factors have now been endorsed by both the 9th Circuit and the Federal Circuit.[6] As a result, it is increasingly likely that this methodology will be used in future judicial determinations of RAND royalty rates in patent infringement actions related to SEPs and in breach of contract lawsuits similar to the *Microsoft-Motorola* case.
6. **Holders of SEPs should exercise caution in filing for injunctive relief related to infringement of SEPs.** Because holders of SEPs are generally prohibited from seeking injunctive relief, they may be liable for substantial damages resulting from an action for such relief. For example, Motorola was found liable for more than $10 million in costs that Microsoft incurred to guard against the economic loss that it would have suffered if Motorola's action for injunctive relief in Germany had been granted.

Recommendations for potential licensees

We recommend that potential licensees consider the following in the wake of the *Microsoft-Motorola* decision:

1. **Review RAND offers carefully and respond in good faith.** Because SEP holders have to be very careful in bringing an infringement case and have potential exposure if their offer is not consistent with their RAND obligations, potential licensees should make sure they are responding on good faith, but realize that they have remedies if the SEP holders are being unreasonable.
2. **The Ninth Circuit's methodology for determining RAND rate is a useful way to evaluate RAND offers.** The Georgia-Pacific factor methodology provide a useful methodology to evaluate potential RAND offers made by SEP Holders and can provide guidance for any potential responses to such offers.
3. **As long as a potential licensee has negotiated in good faith, it is unlikely that the SEP holder can obtain an injunction if the parties are unable to reach agreement on license terms.** As noted above, there is an emerging consensus that a patent owner subject to RAND commitments is generally prohibited from seeking injunctive relief, at least where the potential licensee has acted in good faith.

Notes

1. *Microsoft Corporation v. Motorola, Inc., et al.,* No. 14-35393, 2015 U.S. App. LEXIS 13275 (9th Cir. July 30, 2015).
2. The Ninth Circuit uses the term "RAND" throughout the opinion, although it notes in footnote 2 that, "The parallel terms of some SEP licensing agreements require fair, reasonable, and nondiscriminatory, or 'FRAND' rates. FRAND and RAND have the same meaning in the world of SEP licensing and in this opinion."
3. *Microsoft Corporation v. Motorola, Inc., et al.,* No. C10-1823, (W.D. Wash. April 25, 2013), 2013 U.S. Dist. LEXIS 60233.
4. The 802.11 wireless local area network standard is set by the Institute of Electrical and Electronics Engineers (IEEE), pertains to the wireless transfer of information using radio frequencies commonly referred to as "WiFi," and is incorporated into Microsoft's Xbox video game console. The H.264 video-coding standard is set by the International Telecommunications Union (ITU), pertains to an efficient method of video compression, and is incorporated into Microsoft's Windows operating system and the Xbox.
5. *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), mod. And aff'd, 446 F.2d 295 (2nd Cir. 1971), cert. denied, 404 U.S. 870 (1971).
6. *Ericsson v. D-Link*, 773 F.3d 1201 (Fed. Cir. 2014)

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