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What Is a RAND Licensing Rate? The Ninth Circuit Weighs In

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Summer has ended, and SEP and FRAND issues are in the air. On July 8, the Japan Fair Trade Commission (JFTC) sought public comments on its proposed amendments to its Guidelines for the Use of Intellectual Property under the Antimonopoly Act, which include guidance on the enforcement of standard-essential patents (SEPs).¹ On July 16, the European Court of Justice issued its ruling in *Huawei v. ZTE*, which sets forth the factors to determine when enforcement of SEPs subject to commitments to license on fair, reasonable, and non-discriminatory terms (FRAND) may violate European competition law.² On July 30, the Ninth Circuit issued its highly anticipated decision in *Microsoft v. Motorola*.³

The Ninth Circuit's decision is the first appellate review of a full-blown district court determination of RAND rates.⁴ Only a few other district courts have dealt with the issue of how to determine RAND rates,⁵ and the Federal Circuit has provided only limited guidance.⁶ The district court's decision in *Microsoft v. Motorola*, which set forth a comprehensive framework for determining RAND rates, therefore attracted considerable attention. Not surprisingly, the appeal prompted numerous *amici* to offer various points of view on the appropriate framework.

Although the Ninth Circuit affirmed the district court's decision, the decision does not end the debate. It does, however, provide guidance on critical procedural, substantive, and evidentiary issues related to

the enforcement of SEPs subject to RAND commitments. The case thus sets important precedent in this area.

Background

In October 2010, Microsoft sued Motorola in the International Trade Commission (ITC) and the Western District of Washington asserting various smartphone patents. After some discussions between the parties, Motorola sent Microsoft letters offering to license patent portfolios covering the 802.11 wireless standard and the H.264 video compression standard for a royalty of 2.25 percent of the price of the end product, regardless of manufacturer (*i.e.*, Microsoft would pay Motorola 2.25 percent of the actual sale price of an Xbox, not just the price of the component implementing H.264, or a computer running Microsoft Windows, not just the price of Windows itself). The 802.11 wireless standard is set by the Institute of Electrical and Electronics Engineers (IEEE), and the H.264 standard is set by the International Telecommunications Union (ITU), each of which has established a patent policy requiring patents embodied in a standard to be offered at RAND rates. Motorola asserted in each letter that the offer was consistent with its RAND commitments.

In response to Motorola's letters, Microsoft filed suit in the Western District of Washington asserting that Motorola had breached its RAND commitments to the IEEE and ITU. Motorola, in turn, filed suits against Microsoft in the Western District of Wisconsin seeking to enjoin Microsoft from practicing Motorola's H.264 patents, in the ITC seeking an exclusion order barring importation of Xbox products into the United States, and in Germany (where Microsoft's European distribution center was located) seeking to enjoin Microsoft from selling H.264-compliant products. Microsoft amended its complaint to allege that Motorola's filing of injunctive actions constituted a breach of contract, as the obligation to offer RAND licenses prohibited Motorola from seeking injunctions.

Microsoft also took action to avoid the impact of injunctive relief. It relocated its distribution

center from Germany to the Netherlands. In addition, Microsoft sought and obtained an anti-suit injunction, which the Ninth Circuit affirmed, barring Motorola from enforcing any injunction obtained by the German court.

In Microsoft's breach of contract case, the district court held that Microsoft, as a third-party beneficiary, could enforce Motorola's RAND commitments to the standards setting organizations. The court conducted a bench trial to determine a RAND rate and range, which it found necessary to determine whether Motorola breached its obligations.

In doing so, the district court set forth a framework for the determination of a RAND rate. According to the court, a RAND rate should:

1. Be consistent with the relevant "SSO's goal of promoting widespread adoption of their standards";
2. "Mitigate the risk of patent hold-up";
3. "Address the risk of royalty stacking";
4. Ensure that "holders of valuable intellectual property will receive reasonable royalties on that property"; and
5. Be based "on the economic value of its patented technology itself, apart from the value associated with incorporation of the patented technology into the standard."

Based on this framework, the district court modified a number of the 15 standard *Georgia-Pacific* factors used to determine a reasonable royalty rate. For example, the district court found that factors 4 ("licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly") and 5 ("the commercial relationship between the licensor and licensee") are inapplicable in the RAND context.¹² The district court also included some present-day evidence in connection with factor 15, which is typically "the amount that a licensor and a licensee would have agreed upon (at the time the infringement began)."¹³

Applying the modified *Georgia-Pacific* factors, the court determined that the RAND royalty range for the H.264 portfolio was from 0.555 cents per unit to 16.389 cents per unit.¹⁴ The court concluded that the appropriate rate within this range was the low end, 0.555 cents per unit, because it could find no reason Microsoft would pay more than the low end of the range for the technology represented by Motorola's H.264 portfolio.¹⁵ The court determined further that the RAND royalty range for the 802.11 portfolio was from 0.8 cents per unit to 19.5 cents per unit.¹⁶ The

court concluded that the appropriate rate within that range was 3.471 cents per unit for Xbox products and the low end, 0.8 cents per unit, for all other products using the 802.11 standard.¹⁷ In comparison, 2.25 percent (the rate offered in Motorola's letters to Microsoft) of the price currently listed on Microsoft's Web site for the newest version of the Xbox (\$349) is \$7.85, or 20 times the total of the high end of the ranges for both patent portfolios set by the district court.¹⁸

A jury trial proceeded on the breach of contract claim. Microsoft sought as damages the costs of defending against Motorola's injunctive actions and relocating Microsoft's distribution center from Germany to the Netherlands. The court admitted, over Motorola's objection, the above RAND rates. The court also admitted, again over objection, testimony that the Federal Trade Commission (FTC) had investigated Motorola for failing to license patents on RAND terms.

The jury returned a verdict in Microsoft's favor in the amount of \$14.52 million. Motorola moved for judgment as a matter of law, which the court denied. Motorola appealed to the Federal Circuit, which transferred the appeal to the Ninth Circuit on Microsoft's motion.

The Ninth Circuit's Decision

The Ninth Circuit addressed five key issues bearing on disputes involving SEPs and RAND commitments: (1) the appropriate framework for determining a RAND royalty rate; (2) whether the court, rather than the jury, can decide what is a RAND rate; (3) what constitutes a breach of a RAND commitment; (4) the appropriate appellate court to decide these types of issues; and (5) what are the appropriate damages for breach of a RAND commitment.

1. The Appropriate Framework to Determine a RAND Rate

The Ninth Circuit decision gives guidance on the appropriate framework for determining a RAND royalty rate. The district court's framework for determining a RAND rate and its consequent modified *Georgia-Pacific* analysis were the subject of several *amici* briefs. Several *amici* supported the district court's analysis. Others argued that the district court erred by modifying the *Georgia-Pacific* factors. Motorola argued that the district court's analysis "violated Federal Circuit patent damages law" and misapplied *Georgia-Pacific*.

Reiterating that this was not a patent law action—and thus Federal Circuit law was not controlling—the

Ninth Circuit held that the district court's analysis was nonetheless consistent with Federal Circuit precedent, that the district court properly applied a hypothetical negotiation framework, and that the district court did not err in determining certain licenses to be comparable and others not. The Ninth Circuit specifically noted that although "Motorola criticizes the district court's approach, it provides no alternative other than strict adherence to the *Georgia-Pacific* factors, without accounting for the particulars of RAND agreements—a rigid approach disapproved by the Federal Circuit."¹⁹

Motorola's chief argument was that the district court ignored *Georgia-Pacific* factor 15: to set the hypothetical negotiation at "the time the infringement began."²⁰ The district court had taken into account the *present-day* value of Motorola's patents.

Citing the Federal Circuit's admonition that the *Georgia-Pacific* factors are not a "talismán" for royalty rate calculations, the Ninth Circuit noted that the Federal Circuit had cited the district court's decision for the proposition that many of those factors are "contrary to RAND principles."²¹ The Federal Circuit had in fact explained that *Georgia-Pacific* factor 4, which considers whether the licensor has an established policy of "not licensing others" or "granting licenses under special conditions designed to preserve" exclusivity over the patented technology, is inapplicable to a patent subject to a RAND commitment.²² Similarly, the Federal Circuit observed that adjusting factor 8, which considers the "current popularity" of the invention, may be appropriate in the context of a FRAND obligation to account for the invention's popularity being "inflated because a standard requires the use of the technology."²³

The Ninth Circuit held that factor 15 also "merits modification in some RAND contract contexts."²⁴ Motorola had maintained its demand of 2.25 percent throughout the proceedings, and Microsoft argued that the consistent demand was an ongoing breach. In addition, the "time the infringement began" is not clear when the claim at issue is a breach of contract claim, rather than a patent infringement claim. Moreover, Motorola itself introduced evidence of patent value not tied to a specific moment in history. The Ninth Circuit thus held that the district court had properly applied the hypothetical negotiation approach.

The decision also addresses the issue of a comparable license for a RAND rate determination. Motorola also argued that the district court weighed certain patent pool rates too heavily and Motorola's

own historical licenses too lightly. The district court considered patent pool rates comparable because they were designed with the objective of encouraging widespread adoption of the standard (one of the goals the district court had found for RAND commitments), the court had adjusted the pool rates to account for benefits not present in a bilateral agreement (*e.g.*, grant-back licenses and promotion of the standard), and the court considered the rates as just one factor of many in setting the RAND rates. Other historical licenses that Motorola urged the district court to consider were distinguishable for various reasons, including because they were part of a broader agreement to settle infringement claims, part of a broad package including non-SEPs, or entered into with monetary caps and under threat of litigation.

2. Whether the Court or the Jury Sets the RAND Rate

The Ninth Circuit also weighed in on the issue of whether the court, rather than the jury, can decide what a RAND rate is. On this issue, the court held that Motorola had consented to the bench trial.

Motorola's counsel had agreed at a status conference that the court would decide the material terms of the RAND license, but argued on appeal that its consent was limited to a bench-trial determination of the terms of an agreement the court was planning to craft between the parties. The Ninth Circuit held that Motorola's consent was not so limited, and that the district court had alerted the parties several times that it would use the RAND rate as guidance for the breach of contract claim.

Importantly, Motorola had not argued before the district court or on appeal that the bench trial violated the company's Seventh Amendment rights.²⁵ The Ninth Circuit noted that "the very fact that the court's findings of fact and conclusions of law overlap with the issues in the breach of contract trial could give rise to a Seventh Amendment problem if Motorola did not waive its right to a jury trial on those findings."²⁶

3. What Constitutes a Breach of a RAND Commitment?

The Ninth Circuit decision also gives guidance regarding what constitutes the breach of a RAND commitment. The court found that there was substantial evidence to support the jury's verdict of a breach of the duty of good faith and fair dealing. The Ninth Circuit noted that the jury had heard testimony from five experts that Motorola's actions were "intended to induce hold-up, that is, to pressure

Microsoft into accepting a higher RAND rate than was objectively merited.”²⁷ There also was evidence that an injunction against Microsoft would have been “crippling.” Evidence that the rates Motorola sought were significantly higher than the RAND rate found by the court existed as well. The fact that Motorola sought injunctions “immediately after the twenty-day acceptance window provided in the offer letters expired” also suggested the letters were “no more than a prelude to allow Motorola to be able to say, ‘We’ve made an offer. They didn’t accept it. Now we can sue.’”²⁸ In addition, the evidence that the FTC had investigated Motorola suggested that injunctions were inconsistent with RAND commitments, yet Motorola left its injunctive suits in place.

4. What Are the Appropriate Damages for Breach of a RAND Commitment?

Turning to damages, the Ninth Circuit held that the *Noerr-Pennington* doctrine, which shields individuals from liability for engaging in litigation, did not immunize Motorola from damages liability, because that doctrine does not apply to breaches of contract. The court found that if the law were otherwise, “every settlement of a lawsuit would be unenforceable as a *Noerr-Pennington* violation.”²⁹ The doctrine protects the First Amendment right to petition for redress, but enforcing a contractual commitment to refrain from litigation does not violate that right.

The court also held that the traditional American Rule against awarding attorney fees, which Washington courts follow, did not ban recovery of fees as damages. The fees at issue did not arise from Microsoft’s breach of contract claim but in defending against the injunctive action. The fees were thus not same-suit fees; they were losses independent of the current litigation triggered by contract-breaching conduct.

5. The Appropriate Appellate Jurisdiction

Another key issue in RAND disputes is the appropriate appellate jurisdiction. The Federal Circuit has exclusive jurisdiction over all appeals arising under the patent law. The Ninth Circuit, however, held that it, not the Federal Circuit, was the appropriate court to review the judgment on Microsoft’s breach of contract claims.

The Ninth Circuit previously had exercised jurisdiction over the district court’s anti-suit injunction against Motorola, reasoning that Microsoft’s action “sounds in contract.” The Federal Circuit found

that this decision was not clearly erroneous when transferring the appeal from judgment to the Ninth Circuit.

Holding that this jurisdictional ruling was the law of the case, the Ninth Circuit found no clear error or manifest injustice in exercising jurisdiction over the appeal from the judgment. The court rejected the argument that holding a bench trial on the RAND rate “morphed” the case into one requiring the determination of a “substantial question of federal patent law.”³⁰ The court further held that a complaint alleging breach of contract sounds in contract, regardless of whether the contract is a patent license. Although the calculation of “appropriate royalty amounts in contractual patent license cases involves similar determinations to those that arise when calculating damages in patent infringement cases,” Motorola had cited no case in which the Federal Circuit “exercised jurisdiction over a breach of contract claim for damages where the mode of calculating damages, not any pure patent issue, was at stake.”³¹

Conclusion

The *Microsoft v. Motorola* decision presents an important stage in the developing law regarding SEPs and RAND commitments. Although the Ninth Circuit did not address specifically every aspect of the district court’s framework, the decision does hold that a modified *Georgia-Pacific* analysis may be appropriate for the determination of RAND rates. Moreover, the decision confirms that seeking injunctive relief for infringement of SEPs may in some circumstances be a breach of a RAND commitment.

The decision does not, however, answer all the questions raised by the enforcement of SEPs. Although the Ninth Circuit affirmed the district court’s royalty determination, several aspects of the case may limit the decision’s reach. First, the court held that regional law governs the determination of RAND royalty rates in breach of contract actions but Federal Circuit law governs such determinations in patent damages actions. This leaves the potential for a divergence between circuits and between regional circuits and the Federal Circuit on the appropriate framework for RAND rate determinations. Second, the court reached its decision in the context of the waiver of Seventh Amendment rights. Whether and how the Ninth Circuit’s guidance applies in a case involving a jury determination of RAND rates remains to be seen.

1. JFTC, Press Release, Request for Public Comments on Partial Amendment of "Guidelines for the Use of Intellectual Property under the Antimonopoly Act" (Draft) (July 8, 2015), <http://www.jftc.go.jp/en/pressreleases/yearly-2015/July/150708.html>.
2. Client Alert, Morrison & Foerster LLP, "The European Court of Justice on Enforcement of FRAND Patents: *Huawei v. ZTE*" (July 27, 2015), <http://www.mofo.com/~media/Files/ClientAlert/2015/07/150727ECJFRAND Patents.pdf>.
3. *Microsoft Corp. v. Motorola, Inc.*, No. 14-35393, 2015 U.S. App. LEXIS 13275 (9th Cir. July 30, 2015).
4. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013).
5. *Realtek Semiconductor Corp. v. LSI Corp.*, No. C-12-3451-RMW, 2014 U.S. Dist. LEXIS 81673 (N.D. Cal. June 16, 2014); *CSIRO v. Cisco Sys.*, No. 6:11-cv-343, 2014 U.S. Dist. LEXIS 107612 (E.D. Tex. July 23, 2014).
6. *Ericsson, Inc. v. D-Link Sys.*, 773 F.3d 1201 (Fed. Cir. 2014).
7. *Microsoft*, 2013 WL 2111217 at *12.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.* at *18.
13. *Id.* at *20.
14. *Id.* at *4.
15. *Id.* at *85.
16. *Id.* at *4.
17. *Id.*
18. <http://www.xbox.com/en-US/> (last visited August 1, 2015).
19. *Microsoft*, 2015 U.S. App. LEXIS 13275, at *49-50.
20. *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).
21. *Microsoft*, 2015 U.S. App. LEXIS 13275, at *39 (quoting *Ericsson*, 773 F.3d at 1230).
22. *Ericsson*, 773 F.3d at 1230.
23. *Id.* at 1231.
24. *Microsoft*, 2015 U.S. App. LEXIS 13275, at *40.
25. *Id.* at *30 n.11.
26. *Id.* at *73.
27. *Id.* at *53.
28. *Id.* at *54.
29. *Id.* at *60.
30. *Id.* at *26-27 (quotation omitted).
31. *Id.* at *29.

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