

CLIENT ALERT

Much-Anticipated Decision On Rates To License Standard Essential Patents Issues

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The first federal court decision setting a reasonable and non discriminatory (RAND) licensing rate for standard-essential patents (SEPs) issued last week in the closely watched Microsoft v. Motorola case in the Western District of Washington. Judge James L. Robart's 200-plus page ruling sets a framework to determine RAND rates, relying heavily on pool rates, and is expected to be argued in future disputes regarding RAND commitments and SEPs.

The case involves Motorola patents essential to wireless networking and video coding standards¹, which are encumbered by RAND obligations as a result of Motorola's participation in the standard-setting activities related to those technologies. Microsoft, manufacturer of the Xbox, which reads on the standards, sued Motorola for allegedly breaching its RAND obligations by demanding as a license fee 2.25 percent of every Xbox sale. To decide whether Motorola had breached its RAND obligation, the court determined that it must first establish a RAND rate. To address that issue, the court held a bench trial in November 2012, which resulted in this recent decision.

At the trial, the court heard from 18 witnesses, including multiple economists and technical experts for each side. Microsoft argued that Motorola's demand amounted to a "hold-up royalty" made possible only as a result of the patents' incorporation into the video coding and wireless networking standards. Microsoft argued for an "ex ante multilateral approach," under which the RAND rate would be calculated by approximating the licensing rates set by the patent pools that license other patents essential to the standards at issue. Motorola, on the other hand, asked the court to determine licensing rates based on a hypothetical bilateral negotiation, applying the well-known *Georgia-Pacific* factors used in the patent infringement context. Motorola argued that its usual 2.25 percent rate should be the starting point for that negotiation, with the proper licensing range for negotiation determined by the factors usually used in patent infringement litigation, including licensing benchmarks and the relative importance of the patented technology.

To determine a RAND rate, Judge Robart set forth a framework adopting Motorola's proposed hypothetical bilateral negotiation standard, but adjusting the *Georgia-Pacific* factors to account for the value of the patents to the standard at issue, and to take into consideration pool license rates as a critical benchmark. According to the court, that value should "mitigate the risk of patent hold-up that RAND commitments are intended to avoid," while also reflecting the fact that to "induce the creation of valuable standards, the RAND commitment must guarantee that holders of valuable intellectual property will receive reasonable royalties on that property." The court held that the proper RAND rate reflects the importance of the standard-essential patents to the standard, as well as the importance of the standard to the products at issue. Judge Robart applied this framework to each of the patent portfolios at issue, first evaluating the importance of the patent to the standard, and then considering the importance of the standard to the end product.

In a detailed analysis, the court largely sided with Microsoft as to the value of each of Motorola's patents. First, the court agreed with Microsoft's argument that Motorola's video coding patents "provide only minor importance to the overall functionality of Microsoft's Xbox product." Similarly, the court adopted Microsoft's argument that Motorola's security and encryption

technologies used in wireless networking contribute "very little technology" to the 802.11 standard, and that Microsoft itself – as opposed to the 802.11 standard – provides most of the security and encryption for game-playing functionality. The court also favored Microsoft's position as to the appropriate benchmark licenses. The court found that Motorola's licenses with RIM and other companies were not comparable, and instead held that the patent pool licenses² that Microsoft identified as benchmarks could "serve as indicators of a royalty rate that falls within the range of royalties consistent with the RAND commitment." Ultimately, those much lower pool rates formed the starting point for Judge Robart's rate-setting calculations.

Although the court relied heavily on pool rates as benchmarks, it acknowledged that "a rate higher than a pool rate could still be RAND." Specifically, the court noted that because pools compensate all pool members based on the number of patents they submit to the pool, rather than based on the relative importance of the member's patents to the standard, a pool rate might not necessarily reflect the fee that would have resulted from a hypothetical negotiation in which the parties would be likely to weigh the importance of the specific patent holder's patent to the implementer's particular product. The court also determined that in a hypothetical negotiation, the parties would consider the incremental value of the patent over alternatives available before implementers were "locked in" to the standard – another factor that pools do not weigh in setting a pool rate. The court also noted that pools provide additional value to licensors over and above the royalties they collect, namely "unfettered access to the intellectual property of the pool." Based on this reasoning, the court determined that a RAND range may be bound by pool rates at the "low end," and a rate that emphasizes the importance of the particular patent at issue to the standard, and to the specific product functionality, at the "high end." Applying this framework to the facts, Judge Robart set a rate close to the pool rates proposed by Microsoft, with a very slight upward adjustment to account for the incremental value of Motorola's patents.

The modified bilateral negotiation framework designed and applied by Judge Robart offers guidance in an area where little has existed up to this point. Industry participants, standard-setting organizations and government regulators have long struggled with how to quantify RAND. For that reason, this highly anticipated decision is sure to be heavily analyzed and cited in the months and years to come.

¹ The technical standards at issue are the IEEE 802.11 WiFi standard (for communications between wireless devices and computers) and the H.264 video codec standard (for coding and decoding high definition video, including web video).

² The pool licenses the court considered are (1) MPEG-LA's H.264 pool license; and (2) Via Licensing's 802.11 pool license.

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