A First for Fair, Reasonable and Non-Discriminatory (FRAND): Federal Court in Microsoft v. Motorola Sets FRAND Royalty Rates for Standard Essential Patents

Article By:

Antitrust & Competition Practice

Microsoft v. Motorola developed a framework for courts to assess fair, reasonable and non-discriminatory (FRAND) terms for standard-essential patents. Its roadmap and analysis will probably influence future FRAND cases in other U.S. and international jurisdictions.

In Microsoft v. Motorola, the U.S. District Court for the Western District of Washington became the first U.S. court to set fair, reasonable and non-discriminatory (FRAND or RAND) royalty rates and range for standard-essential patents (SEPs). The court's analysis employed a modified version of the *Georgia-Pacific* factors, which courts use to calculate "reasonable royalty" damages in patent infringement actions. The analysis is modified because FRAND royalties for SEPs differ from typical "reasonable royalty" damages. Typical patent holders are not obligated to license their patents. In contrast, SEP holders—in an effort to encourage widespread adoption of standard technologies that use their patents—contractually obligate themselves (via standard-setting organizations) to license their SEPs on FRAND terms. The suit stems from Microsoft's allegation that Motorola's offers to license certain Wi-Fi and video compression SEPs were too high and therefore violated Motorola's contractual FRAND commitments.

The Court's FRAND-Specific Analysis

Microsoft v. Motorola is important because it developed a framework for courts to assess FRAND terms for SEPs. Microsoft urged that the analysis should hinge on "the incremental value of the [patented] technology compared to the alternatives that could have been written into the standard [thereby focusing] on the period before the standard was adopted and implemented." Motorola, on the other hand, argued "that RAND terms and conditions can be determined by simulating a hypothetical bilateral negotiation under the RAND obligation." The court largely agreed with Motorola's framework (having concluded that courts cannot practically implement Microsoft's approach, and that it "lack[s] real-world applicability" because antitrust concerns often keep standard-setting organizations from engaging in prospective discussion of licensing terms). However, the court nevertheless issued a very Microsoft-favorable ruling.

In setting forth the basic principles at issue, the court stated that "RAND royalt[ies] should be set at a level consistent with the [standard-setting organizations]' goal of promoting widespread adoption of their standards," and the proper methodology "address[es] the risk of royalty-stacking by considering the aggregate royalties that would apply if other SEP holders made royalty demands of the implementer." Fundamentally, "a RAND commitment should be interpreted to limit a patent holder to a reasonable royalty on the economic value of its patented technology itself, apart from the value associated with incorporation of the patented technology into the standard." So, "the court adopt[ed] a modified version of the *Georgia-Pacific* factors to recreate a hypothetical negotiation between the parties," focusing its analysis on its conclusion that "the parties in a hypothetical negotiation would set RAND royalty rates by looking at the importance of the SEPs to the standard and the importance of the standard and the SEPs to the products at issue." The following table summarizes the*Georgia-Pacific* factors and the *Microsoft* court's modified application for FRAND cases:

***Georgia-Pacific* factors**	***Microsoft v. Motorola's* modified factors for setting FRAND royalties**
1. Royalties received by the patentee for the patent(s) at issue	The royalties considered here "must be comparable to RAND licensing circumstances,*i.e.*, both "license agreements where the parties clearly understood the RAND obligation, and . . . patent pools, will be relevant to a hypothetical negotiation for SEPs. The court noted that "as a general matter [] patent pools tend to produce lower rates than those that could be achieved through bilateral negotiations," so while "a pool rate itself does not constitute a RAND royalty rate for an SEP holder who is not a member of the pool . . . , under certain circumstances, patent pools can serve as indicators of a royalty rate that falls within the range of royalties consistent with the RAND commitment."
2. Rates paid by the licensee to use comparable patents	The court did not expressly address this factor, although it strongly considered the MPEG LA H.264 patent pool (similar to the H.264 patents at issue), in which Microsoft is a licensor and licensee.
3. The nature and scope of the license	The court did not address this factor.
4. The licensor's policy and marketing program to maintain its patent monopoly (via selective licensing)	"This factor is inapplicable in the RAND context because the licensor has made a commitment to license on RAND terms and may no longer maintain a patent monopoly by not licensing to others."
5. The commercial relationship between the licensor and licensee	"[T]his factor does not apply in the RAND context . . . because having committed to license on RAND terms, the patentee no longer may discriminate against its competitors in terms of

	licensing agreements.”
6. The effect of selling the patented specialty in promoting sales of the licensee’s and licensor’s other products	“[I]t is important to focus the analysis . . . on the value of the patented technology apart from the value associated with incorporation of the patented technology into the standard,” along with “the contribution of the patent to the technical capabilities of the standard and also the contribution of those relevant technological capabilities to the implementer and the implementer’s products” (this, “because there is substantial value in the agreed standard itself”).
7. The duration of the patent and the term of the license	“The analysis concerning Factor 7 is greatly simplified . . . because the term of the license would equate to the duration of the patent.”
8. The established profitability of the product made under the patent	The court applied the same considerations it applied to factor 6 above.
9. The utility and advantages of the patent property over the old modes or devices	“Through this factor, the parties to a hypothetical negotiation under a RAND commitment would consider alternatives that could have been written into the standard instead of the patented technology. The focus is on the period before the standard was adopted and implemented.” (Note, this is how the court utilized Microsoft’s approach.)
10. The nature of the patented invention and the character of the commercial embodiment of it as owned and produced by the licensor	This factor focuses on “the hypothetical negotiation [regarding] the contribution of the patent to the technical capabilities of the standard and also the contribution of those relevant technical capabilities to the implementer and the implementer’s products.”
11. The extent to which the infringer has made use of the invention, and any evidence probative to the value of that use	The court applied the same considerations it applied to factor 10 above.
12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions	This factor “must look to customary practices of businesses licensing RAND-committed patents” as opposed to “non-RAND committed patents.”
13. The portion of the realizable profit that should be credited to the invention itself	“As with many of the other factors, in the RAND context, it is critical to consider the contribution of the patented technology apart from the value of the patent as the result of its incorporation into the standard, the latter of which would properly reward the SEP owner for the value of the standard itself.”

14. The opinion testimony of qualified experts	The court did not expressly address this factor, although it did consider substantial expert testimony.
15. The amount that a licensor and a licensee would have agreed upon at the time infringement began if both had been reasonably and voluntarily trying to reach an agreement	"In trying to reach an agreement, the SEP owner would have been obligated to license its SEPs on RAND terms which necessarily must abide by the purpose of the RAND commitment of widespread adoption of the standard through avoidance of hold-up and stacking. "With respect to hold-up, the parties would examine a reasonable royalty rate . . . based on the contribution of the patented technology to the capabilities of the standard, and in turn, the contribution of those capabilities of the standard to the implementer and the implementer's products." "With respect to stacking concerns, the parties attempting to reach an agreement would consider the overall licensing landscape in existence vis-à-vis the standard and the implementer's products." "Finally, reasonable parties in search of a reasonable royalty rate under the RAND commitment would consider 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."

Result

Motorola argued that it was entitled to a royalty rate of 2.25 percent of the net selling price of Microsoft's Windows and Xbox products for both its H.264 and 802.11 SEP portfolios (*i.e.*, $4.50 for each $200 Xbox). Microsoft argued that the MPEG LA H.264 patent pool is the best indicator of a FRAND royalty rate for Motorola's H.264 SEPs. The court reached several Microsoft-favorable conclusions. Importantly, it found that several of Motorola's patents provided only minimal contribution to the standards and played only minor importance in the overall functionality of some of Microsoft's products. Also, the court concluded that "[b]ecause the characteristics of the MPEG LA H.264 pool [of which Microsoft and Google, Motorola's parent, are members] closely align with all of the purposes of the RAND commitment, . . . the pool rate is a strong indicator of a RAND royalty rate for Motorola's H.264 portfolio." And regarding Motorola's 802.11 SEP portfolio, the court found that the Via Licensing 802.11 patent pool is an indicator of a FRAND royalty rate, albeit not a strong indicator because neither Microsoft nor Motorola were in the pool, and the pool had not been successful in encouraging widespread adoption of the standard.

The court ultimately favored Microsoft, holding that the FRAND royalty rate for Motorola's H.264 SEP portfolio is 0.555 cents per unit, with the range set at 0.555 to 16.389 cents per unit for Windows and Xbox products. For all other Microsoft products, the rate is 0.555 cents per unit. The court set the FRAND royalty rate for Motorola's 802.11 SEP portfolio at 3.471 cents per unit, with the range set at 0.8 to 19.5 cents per unit for Xbox products. For all other Microsoft products, the royalty rate is 0.8 cents per unit. In total, this is about $560,000 per year above Microsoft's proposal, but about $4 billion below Motorola's demand.

The case is slated to proceed to trial later in 2013 to determine whether Motorola's 2.25 percent offer violated its FRAND obligations. Assuming Motorola appeals, the applicable court of appeals could be at issue (as a breach of contract action in Washington, the U.S. Court of Appeals for the Ninth Circuit would normally hear the appeal, but because it centers on patent issues, it could end up at the U.S. Court of Appeals for the Federal Circuit).

Practical Impact – Why *Microsoft v. Motorola* Matters

Microsoft v. Motorola is precedential only in the Western District of Washington, but at 207 thorough and well-reasoned pages, it provides a valuable roadmap and will probably influence courts in other U.S. and international jurisdictions deciding future FRAND cases (if it is not overturned on appeal). However, its application might not always be licensee-favorable. *Microsoft v. Motorola* presented substantial and potentially unique evidence, for instance, of patent pools relating to the standards at issue, that the SEPs at issue were not particularly valuable as compared to other patents essential to the standards (particularly for the uses at issue), and of similar (low) valuation analyses commissioned by the patent holder.

In any event, both licensors and licensees of SEPs should take serious note of *Microsoft v. Motorola*.

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