

An Unreasonable Royalty Rate is No Gaming Matter Re: Patent Litigation

Article By:

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The Honorable Judge James L. Robart recently took on the challenging task of determining a reasonable and non-discriminatory (“RAND”) royalty rate for Motorola’s standards-essential patents (“SEP”). ***Microsoft Corp. v. Motorola, Inc.***, 2013 U.S. Dist. LEXIS 60233, No. C10-11823 (W.D. Wash. Apr. 25, 2013). This decision comes after a two-year patent war between Microsoft and Motorola. In November 2010, Microsoft filed a breach of contract suit, alleging Motorola breached its obligation to license its SEP at a RAND rate.

Motorola owns patents essential to complying with standards 802.11 of the Institute of Electrical Electronics Engineers (“IEEE”) involving WiFi and H.264 of the International Telecommunication Union (“ITU”) involving video coding. Microsoft requires licenses to comply with these standards for its Xbox 360 gaming console. Motorola offered to license each of the patents at a RAND royalty rate of 2.25% of the price of the end product. This would mean that Microsoft would owe Motorola approximately \$4 billion per year for licensing its patents. However, the court disagreed and found that this rate did not fall within the range of RAND royalties. The court undertook a methodical analysis to knock the amount down to about \$1.8 million. In determining the RAND royalty rate for Motorola’s 802.11 SEP, the court first determined that the appropriate RAND royalty range is between .555 and 16.389 cents per unit. The court found that the RAND royalty rate is .555 cents per unit for Xbox products. In determining the RAND royalty rate for Motorola’s H.264 SEP, the court determined that the appropriate RAND royalty range is between .8 cents and 19.5 cents per unit. The court found that the RAND royalty rate is 3.471 cents per unit for Xbox products.

In its 207-page opinion, the court came to its conclusion, in part, by looking to the policy reasons behind RAND and the importance of providing a reasonable royalty rate to licensees.

Upholding Competition and Innovation in the Industry

The purpose of RAND is to ensure that SEP owners do not unfairly hinder innovation or competition by unreasonably increasing the royalty rates of licensing their patents. SEP owners are in a powerful position to manipulate the market. For example, one of the purposes of RAND is to prevent “hold-up” – where an SEP owner demands more value than the patented technology or demands the total value of the standard, thereby effectively preventing the licensee from licensing the patent. Additionally, the court noted that hold-ups may also harm other firms that hold SEPs and cannot

obtain royalties because the product is not being developed.

Where there are reasonable royalties, healthy competition is less hindered. Gaming companies, in particular, are competing for the best, most appealing console to consumers. One possible roadblock to this goal is licensing a patent necessary to comply with industry standards. When a gaming company cannot afford to obtain a necessary license that would contribute in making the system competitive with other systems, the product is less likely to be created. This decreases the marketplace of innovations.

Moreover, where there are reasonable royalties on essential patents, companies are less constrained in their innovation. A gaming console that seeks to set itself apart from the competition will likely require the use of multiple patented technologies and compliance with multiple standards. The court noted that “a RAND royalty should be set at a level consistent with the S.S.Os’ (standard setting organizations) goal of promoting widespread adoption of their standards.”

The court’s decision in this case, at the very least, gives guidance for companies in negotiating RAND rates, and also guides courts when parties are unable to come to a resolution.

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