

## **Ninth Circuit Is the First Appeals Court to Rule on RAND/SEP Licensing Microsoft Corp. v. Motorola, Inc. et al.**

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In an appeal challenging a district court's authority to determine royalty rates in a bench trial the U.S. Court of Appeals for the Ninth Circuit has now affirmed a first-of-its-kind district court judgment relating to royalty rates for standard-essential patents (SEP), finding that the patent owner Motorola had consented to the bench trial and concluding that the district court's "thoughtful and detailed analysis" was "consistent with the Federal Circuit's recent approach," to licensing. *Microsoft Corp. v. Motorola, Inc. et al.*, Case No 14-35393 (9th Cir, July 30, 2015) (Berzon, J.).

### **Procedural Background**

As part of the standard setting process, many standards organizations require members who hold patents necessary to implement a given standard to commit to license those patents on reasonable and non-discriminatory terms (RAND). Because inclusion in a standard can increase the importance and value of a patent, parties often differ on what constitutes a reasonable royalty. In this case, district court Judge James Robarts of the U.S. District Court for the Western District of Washington established a multi-factor framework to determine the appropriate royalty rates and ranges for SEPs. Motorola's appeal challenged the district court's authority to determine the royalty rate at a bench trial. The company also contended that the district court misapplied Federal Circuit precedent on patent damages.

The long-running patent dispute between Microsoft and Motorola spans several courts and countries. The crux of the conflict traces back to when Microsoft sued Motorola for alleged infringement of certain smartphone patents. Thereafter, the parties explored a possible cross-licensing arrangement to resolve their dispute. Motorola sent letters proposing licenses for 802.11 and H.264 SEP portfolios, with a proposed royalty rate of 2.25 percent of the price of the end product, which Motorola represented was in keeping with its RAND commitments on the patents. Microsoft disagreed. Soon after, Microsoft filed suit, alleging that Motorola had breached its RAND commitments to the Institute of Electrical and Electronic Engineers (IEEE) and the International Telecommunication Union (ITU), the standard-setting organizations that developed the 802.11 and H.264 standards. Motorola responded by filing suit in a rocket docket jurisdiction, the U.S. District Court for the Western District of Wisconsin, seeking an injunction to prevent Microsoft from using its H.264 patents. The cases

were consolidated before Judge Robart. Motorola also brought patent-enforcement actions before the International Trade Commission and in Germany. Microsoft alleged in an amended complaint that the filing of these injunctive orders constituted a breach of contract on the grounds that a RAND commitment bars a patent holder from seeking injunctive relief.

The district court found that the RAND commitment made by Motorola to the standard-setting organizations created an enforceable contract, which standard users like Microsoft are able to enforce as third-party beneficiaries. Judge Robart determined, however, that, in order for a jury to determine whether Motorola had breached its RAND commitment, it must first know what the RAND commitment meant. Judge Robart held a bench trial to determine a RAND rate and range for Motorola's H.264 and 802.11 SEPs and subsequently issued an order setting forth its findings. The royalty rates and ranges determined by the district court (ranging from a fraction of a cent per unit up to less than 20 cents per unit) were substantially lower than those demanded by Motorola. A jury later returned a verdict for Microsoft on its breach of contract claim. Motorola appealed the judgment on the breach of contract claim to the U.S. Court of Appeals for the Federal Circuit, which, on Microsoft's motion, transferred the appeal to the 9th Circuit (concluding that under the law of the case doctrine, the appeal properly lay with the regional circuit court that had previously heard an interlocutory appeal in this case).

## The RAND Determination

On appeal, Motorola raised two substantive issues. First, Motorola contended that the district court lacked the legal authority to decide the RAND rate issue separate from the ultimate breach of contract issue tried before the jury. Second, Motorola claimed that the district court's legal analysis was contrary to Federal Circuit precedent as it relates to patent damages.

On the matter of the district court's authority to conduct a bench trial to determine the RAND rate, the 9th Circuit held that Motorola affirmatively consented to the bench trial. The court rejected Motorola's claims that its consent was taken out of context and limited to a court-crafted license rather than determination of the RAND rate and range. The court noted that Motorola never raised, at trial or on appeal, any Seventh Amendment claim regarding its right to a jury trial on the RAND rate matter. Given Motorola's affirmative stipulation to a bench trial for the purpose of determining the RAND rate, the court did not consider whether a jury should have made a RAND determination.

Motorola also challenged the district court's legal analysis in its determination of the RAND rate and range. Judge Robart's decision was the first to attempt to establish an appropriate RAND rate. The district court relied upon a modified version of a multi-factor test established in *Georgia-Pacific Corp. v. U.S. Plywood Corp.* and used extensively to determine damages in patent infringement cases. *Georgia-Pacific* lays out 15 factors for a court to consider in establishing the royalty rate that the parties to the dispute might have agreed upon in a hypothetical negotiation. One of the factors requires the court to set the time of the hypothetical negotiation at the time the infringement began. Motorola claimed that the district court incorrectly applied this factor, as interpreted and applied by the Federal Circuit.

The 9th Circuit acknowledged that the district court had applied a "partial present-day focus" but denied this constituted error. It pointed to the Federal Circuit's recent decision in *Ericsson v. D-Link* ([\*IP Update\*, Vol. 18, No. 1](#)) which stated it has "never described the *Georgia-Pacific* factors as a talisman for royalty rate calculations," and which recognized that some of the factors "clearly are not relevant to every case." The court noted that the Federal Circuit had even cited Judge Robart's decision in support of the view that many of the *Georgia-Pacific* factors are "contrary to RAND

principles” and courts thus need to take a flexible approach to such cases. The court highlighted that *Georgia-Pacific*’s focus on the date of the patent infringement was inapt in a breach-of-contract case. It also noted the impracticality of tying the value of the patents to a particular moment in time given the evidence the parties presented. Finally the court emphasized that Motorola had neither shown, nor even argued, that it had been prejudiced by the court’s analysis. The court ultimately concluded that, given the need for flexibility in determining royalty rates for RAND-encumbered patents and given no prejudice was shown, the district court properly applied the hypothetical agreement approach.

**Practice Note:** The Ninth Circuit’s decision, coming in the wake of last year’s Federal Circuit decision in *Ericsson v. D-Link*, further confirms that courts will apply a flexible, fact-specific approach to determine the appropriate royalty rate in cases involving RAND-encumbered SEPs. Both the Federal Circuit and the 9th Circuit have now rejected the view that *Georgia-Pacific* or any other test can be rigidly applied in all circumstances. The approval of the framework employed by Judge Robarts, however, is likely to encourage its continued use as a starting point in future rate determinations.

Indeed, soon after the Western District of Washington decision by Judge Robart, Judge Holderman, in the case of *In re Innovatio IP Ventures, LLC Patent Litig.*, also held a bench trial and, using a variation on the RAND analysis pioneered by Judge Robart, determine RAND rates for 802.11 SEPs, as applied to manufacturers of Wi-Fi equipment. In two other RAND cases involving the 802.11 Wi-Fi standard, *Ericsson v. D-Link* (E.D. TX, 2013) before Judge Davis and *Realtek v. LSI* (N.D. CA 2014) before Judge Whyte, the RAND determinations were made by a jury.

In light of the 9th Circuit’s decision in *Microsoft v. Motorola*, practitioners should be aware that, in a breach of contract claim regarding standard-essential patents, the court may conclude that it must determine the RAND terms as a precursor to determining the breach of contract action.

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