

# BREACHING RAND AND REACHING FOR REASONABLE: *MICROSOFT V. MOTOROLA* AND STANDARD-ESSENTIAL PATENT LITIGATION

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Technological innovation is rarely, if ever, created without utilizing prior innovations. As Carl Shapiro noted, “[t]he essence of science is cumulative innovation,” and cumulative innovation “is central to the scientific method.”<sup>1</sup> However, cumulative innovation can be complicated by a vast array of intellectual property rights.<sup>2</sup> These intellectual property rights are particularly problematic in the context of standard setting.<sup>3</sup> In standard setting, any patents that are necessary to implement a chosen standard are labeled standard essential patents (“SEPs”).<sup>4</sup> As new technological creations incorporate prior discoveries, individual patent holders, upon whose technological discoveries broader technological creations are built, are endowed with significant market power to determine licensing rates.<sup>5</sup>

As a result, standard-setting organizations (“SSOs”) typically require their members to commit to license any SEP on reasonable and nondiscriminatory (“RAND”) terms prior to incorporation into a standard.<sup>6</sup> Although the RAND commitment is meant to incentivize adoption of the standard by requiring SEP holders to license on reasonable terms, patentees are given considerable power in setting rates.<sup>7</sup> The power to set rates is magnified by

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1. Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting*, in *INNOVATION POLICY AND THE ECONOMY* 119, 119 (Adam B. Jaffe, Josh Lerner & Scott Stern eds., 2000).

2. *Id.* at 120 (stating that, in light of cumulative innovation, stronger patent rights can stifle innovation by creating a maze of patent rights that innovators must navigate through).

3. *Id.* at 136.

4. *Id.*

5. *Id.*

6. European SSOs typically require their members to license on fair, reasonable and nondiscriminatory terms (“FRAND”). FRAND and RAND are used interchangeably in this Note.

7. See Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1906 (2002). For a more in depth discussion of “reasonableness,” see *infra* Part III.

the lack of guidance as to what “reasonable” licensing means.<sup>8</sup> The lack of guidance as to what is “reasonable” unleashed a flood of litigation seeking to define what constitutes reasonable royalty rates and to establish an enforcement mechanism to the RAND commitment and a remedy for when the commitment is breached.<sup>9</sup>

The so-called “Smartphone Wars” have only fueled this litigation.<sup>10</sup> As a result of the escalation of patent litigation, smartphone makers have sought to increase their mobile technology patent portfolios, which often contain SEPs.<sup>11</sup> Although it has been suggested that smartphone war litigation could be reduced by the cross-licensing of RAND-encumbered patents,<sup>12</sup> continuing litigation has shown that cross-licensing has done little to stem the tide of litigation.<sup>13</sup> In the wake of this litigation, judicial decisions are emerging that use contract law to determine what enforcement mechanisms and remedies exist in light of the RAND commitment and what constitutes “reasonable” for a RAND rate.<sup>14</sup>

These recent judicial determinations are the subject of this Note, which focuses primarily on the district court litigation between Microsoft Corporation and Motorola, Inc. (hereinafter “*Microsoft*”) and discusses how Microsoft’s breach of contract action demonstrates the usefulness of contract law as the enforcement mechanism for the RAND commitment. Additionally, this Note examines Judge Robart’s calculation of the RAND royalty range and discusses how the calculation provides a pathway to “reasonable” RAND royalty rates and a remedy, should licensing negotiations stall. Part I provides a contextual background to *Microsoft* by looking at the rise of standard-essential patent litigation. Part II examines the contractual arguments and decisions of *Microsoft* and subsequent cases, and

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8. Lemley, *supra* note 7 at 1906.

9. For a listing of SEP litigation cases, see *Litigations Involving SEPs*, ESSENTIAL PATENT BLOG (Dec. 20, 2014), <http://essentialpatentblog.com/list-of-litigations-involving-seps>.

10. MIKE LLOYD, DORIS SPIELTHENNER & GEORGE MOKDSI, THE SMARTPHONE PATENT WARS 4 (2011), available at <http://www.iam-magazine.com/blog/articles/GriffithHackSmartphonesReportFinal.pdf>.

11. Thomas H. Chia, Note, *Fighting the Smartphone Patent War with RAND-Encumbered Patents*, 27 BERKELEY TECH. L.J. 209, 213 (2012).

12. *See id.*

13. *See, e.g., In re Innovatio IP Ventures, LLC Patent Litig.*, MDL 2303, 2013 U.S. Dist. LEXIS 144061 (N.D. Ill. Oct. 3, 2013); *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233 (W.D. Wash. Apr. 25, 2013); *Apple, Inc. v. Samsung Elec. Co.*, No. 11-cv-01846-LHK, 2012 WL 2571719 (N.D. Cal. June 30, 2012).

14. *See Microsoft*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233; *Innovatio*, MDL 2303, 2013 U.S. Dist. LEXIS 144061.

demonstrates that the current state of contract law in SEP litigation provides a useful enforcement mechanism to the RAND commitment. Part III examines the first judicial determination of a RAND royalty rate in *Microsoft* and the subsequent determination of a RAND rate in *In re Innovatio IP Ventures, LLC Patent Litigation*.<sup>15</sup> Part IV concludes by discussing how to use recent case law to navigate and, if need be, enforce the RAND commitment.

### I. *MICROSOFT V. MOTOROLA* AND ITS HISTORY

In November 2010, Microsoft filed a breach of contract suit against Motorola.<sup>16</sup> Just one week before filing the suit, Microsoft received an offer letter stating Motorola's licensing terms for their SEPs relating to the Institute of Electrical and Electronics Engineers ("IEEE") 802.11 wireless local area network ("WLAN") standard ("802.11 Standard") and the International Telecommunication Union ("ITU") H.264 advanced video coding technology standard ("H.264 Standard").<sup>17</sup> The complaint alleged that Motorola breached its contractual obligations to the IEEE and ITU to license their SEPs on RAND terms.<sup>18</sup> Motorola offered a royalty rate of 2.25 percent per unit of the end product price for each Microsoft product implementing Motorola's standards, amounting to a \$4 billion cash payment.<sup>19</sup> Three years later, the trial court reached the first final judgment of a RAND rate, and the jury found that Motorola had breached its contractual commitments to the ITU and IEEE to license on RAND terms.<sup>20</sup>

*Microsoft* provided an enforcement mechanism and remedy that the RAND commitment has long been without, a pathway that has been followed in subsequent cases. However, the historic nature of *Microsoft* is better understood with a review of the context underlying SEP litigation and the RAND commitment.

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15. See *In re Innovatio*, 2013 U.S. Dist. LEXIS 144061.

16. *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 877–78 (9th Cir. 2012).

17. *Id.*

18. *Id.* at 878.

19. *Id.*

20. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233 (W.D. Wash. Apr. 25, 2013); Verdict Form at 2, *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 5398081 (W.D. Wash. Sept. 4, 2013).

A. INCENTIVIZING INNOVATION BY EASING THE HOLD OF LEGAL MONOPOLIES

A patent is, at its heart, the right to exclude.<sup>21</sup> This exclusive right of inventors grants a temporary, legal monopoly in order to reward innovation to “promote the Progress of Science and useful Arts.”<sup>22</sup> The tension between innovation and competition in patent law is one that creates interesting and complex challenges in our legal system. SEP litigation is a manifestation of the tension between innovation and competition, spurred by the increased need for interoperability in the technological marketplace and challenged by rapid development and assertion of huge patent portfolios. Standard-setting organizations attempted to mitigate the tension between proprietary rights and the need for interoperability by requiring members whose technology would be incorporated into the standard to promise to license to any implementer of the standard on RAND terms.<sup>23</sup> In a modern economy driven by technological innovation, standards and RAND policies play incredibly important roles.

Broadly defined, standards are “any set of technical specifications that either provides or is intended to provide a common design for a product or process.”<sup>24</sup> In 1997, President Clinton’s administration noted that standards were critical to the “long term commercial success” of emerging technological markets due to the increased interoperability that occurs as a result of standardization.<sup>25</sup> Simply put, interoperability is “the ability of two or more networks, systems, devices, applications or components to exchange information between them and to use the information so exchanged. . . . [P]roducts of one manufacturer can interoperate seamlessly with products from a different manufacturer.”<sup>26</sup> This quality allows technological markets to develop more broadly and with reduced cost to consumers.<sup>27</sup>

21. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391–97 (2006).

22. U.S. CONST. art. I, § 8, cl. 8.

23. *See, e.g., Common Patent Policy for ITU-T/ITU-R/ISO/IEC*, ITU, <http://www.itu.int/en/ITU-T/ipr/Pages/policy.aspx> (last visited Feb. 6, 2014) [hereinafter *ITU Common Patent Policy*].

24. Lemley, *supra* note 7, at 1896.

25. William J. Clinton & Albert Gore, Jr., *A Framework for Global Electronic Commerce at Article III § 9* (July 1, 1997), <http://clinton4.nara.gov/WH/New/Commerce/read.html> (“To ensure the growth of global electronic commerce over the Internet, standards will be needed to assure reliability, interoperability, ease of use and scalability.”).

26. Tim Frain, *Patents in Standards & Interoperability 1* (World Intellectual Property Organization, Nov. 29, 2006), available at [http://www.wipo.int/export/sites/www/meetings/en/2006/patent\\_colloquia/11/pdf/frain\\_paper.pdf](http://www.wipo.int/export/sites/www/meetings/en/2006/patent_colloquia/11/pdf/frain_paper.pdf).

27. *See* Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP. 93, 109 (1994). Standardization across an industry can have significant

Private SSOs typically create standards, which are then adopted through network effects or other market pressures.<sup>28</sup> For example, the 3rd Generation Partnership Program created the 4G LTE standard.<sup>29</sup> LTE launched in parts of Europe in 2009, and the first major American carriers voluntarily switched and launched in 2010, with others quickly following.<sup>30</sup> For a short period of time, CDMA<sup>31</sup> carriers intended to use a rival standard, but after major American, Canadian, and Asian carriers migrated to LTE, CDMA carriers announced that they too would also adopt the LTE standard.<sup>32</sup> Interoperability concerns and market pressures ensured the voluntary and market-wide adoption of a private, SSO-created standard.

The shift from standard setting being done by governmental figures to private-sector SSOs has been occurring for decades.<sup>33</sup> The development of telecommunication standards in 1979 in particular increased involvement from the private-sector SSOs due to rapidly advancing technology and increasing need for interoperability.<sup>34</sup> Private-sector SSOs exist in industries as wide-ranging as aeronautics, manufacturing, power and SmartGrid, health and medicine, e-commerce, defense, telecom, and electronics.<sup>35</sup> SSOs cover technical categories such as multimedia, cloud computing, grid computing, Internet, computer networking, semiconductors, software, web services, etc.<sup>36</sup>

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consumer benefits, such as increasing membership to the industry as a whole, reducing the need to duplicate equipment, and increasing competition. *See id.* at 105–06. The effects of standardization are particularly important in network markets, in which the value of a product to a particular consumer is a function of how many other consumers use the same or a compatible network. *See Lemley, supra* note 7 at 1896.

28. Joseph Farrell et al., *Standard-Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603, 637 n.154 (2007).

29. LTE ENCYCLOPEDIA, <https://sites.google.com/site/lteencyclopedia/home> (last visited Feb. 6, 2014).

30. *Id.*

31. CDMA stands for “code division multiple access,” a channel access method used by various radio communication technologies. *Code Division Multiple Access*, PC MAGAZINE ENCYCLOPEDIA, <http://www.pcmag.com/encyclopedia/term/39462/cdma> (last visited Feb. 6, 2014).

32. Steven Hartley & Julien Grivolos, *LTE: The Future of Mobile Data*, FORBES CUSTOM, <http://www.forbescustom.com/TelecomPgs/LTEP1.html> (last visited Feb. 6, 2014).

33. For more information on the history of standard setting, see MAUREEN BREITENBERG, NAT’L BUREAU OF STANDARDS, U.S. DEPT. OF COMMERCE, *THE ABC’S OF STANDARDS-RELATED ACTIVITIES IN THE UNITED STATES 2–3* (1987).

34. *See* ROBERT W. GARNET, *THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM’S HORIZONTAL STRUCTURE, 1876–1909* (1985).

35. A comprehensive list of SSOs by function is provided by Mark Lemley, *supra* note 7, at 1908.

36. *Id.*

Rising to prominence out of an era of technological advancement—and relevant to this Note—are the IEEE and the ITU. The IEEE’s standard-setting practice dates back to 1890, when the organization was called the American Institute of Electrical Engineers (“AIEE”).<sup>37</sup> In 1963, the AIEE merged with the Institute of Radio Engineers to form the IEEE, and the IEEE continues to support standards development today, including the 802.11 WLAN Standard.<sup>38</sup> The ITU traces its origins to 1865 as the International Telegraph Union.<sup>39</sup> Its current moniker came about in 1932, and its expertise has broadened to cover the entire information and communication technology sector, creating standards for fields ranging from mobile technologies to 3D TV, including the H.264 Video Compression Standard.<sup>40</sup>

Although the rapid technological innovation of the late twentieth century has demonstrated the benefits of SSOs and standards generally, those benefits do not come without complications.<sup>41</sup> Technological standards are often developed with limited acknowledgement of the proprietary nature of the technology incorporated into the standard.<sup>42</sup> And although standards

37. *IEEE History*, IEEE, <http://www.ieeeahn.org/wiki/index.php/IEEE> (last visited Feb. 6, 2014).

38. *History of Institute of Electrical and Electronic Engineers (IEEE) Standards*, IEEE, [http://www.ieeeahn.org/wiki/index.php/History\\_of\\_Institute\\_of\\_Electrical\\_and\\_Electronic\\_Engineers\\_\(IEEE\)\\_Standards](http://www.ieeeahn.org/wiki/index.php/History_of_Institute_of_Electrical_and_Electronic_Engineers_(IEEE)_Standards) (last visited Feb. 6, 2014). The 802.11 Standard is extensively discussed in Part III of this Note. *See infra* Section III.B.4.

39. *Overview of ITU’s History*, ITU, [http://www.itu.int/en/history/Pages/ITUs\\_History.aspx](http://www.itu.int/en/history/Pages/ITUs_History.aspx) (last visited Feb. 6, 2014).

40. *Id.* The H.264 Standard is extensively discussed in Part III of this Note. *See infra* Section III.B.3

41. Although not within the scope of this paper, these complications include numerous antitrust challenges to standard setting. For a non-exhaustive listing, see generally *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872 (9th Cir. 2012); *Rambus Corp. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008); *Apple, Inc. v. Motorola Mobility, LLC*, No. 11-cv-178-bbc, 2012 WL 5416941 (W.D. Wisc. Oct. 29, 2012); *Apple, Inc. v. Samsung Elec. Co.*, No. 11-cv-01846-LHK, 2012 WL 2571719 (N.D. Cal. June 30, 2012); *In re Motorola Mobility LTC*, Docket No. 121-0120 (F.T.C. Jan. 3, 2013); *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297 (3d Cir. 2007); *In re Negotiated Data Solutions LLC (N-Data)*, Docket No. C-4234 (F.T.C. Sept. 22, 2008). *See also* U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 53–56 (2007); IEEE STANDARDS ASS’N, PROMOTING COMPETITION AND INNOVATION: WHAT YOU NEED TO KNOW ABOUT THE IEEE STANDARDS ASSOCIATION’S ANTITRUST AND COMPETITION POLICY (2010), available at <http://standards.ieee.org/develop/policies/antitrust.pdf>.

42. IEEE STANDARDS ASS’N, STANDARDS BOARD BYLAWS § 6.2 (2013), available at [http://standards.ieee.org/develop/policies/bylaws/sb\\_bylaws.pdf](http://standards.ieee.org/develop/policies/bylaws/sb_bylaws.pdf) [hereinafter IEEE BYLAWS] (stating that standards may be drafted to include essential patent claims). For the

incorporate non-proprietary technology, it is inevitable that proprietary technology will be incorporated and implemented. Implementation of proprietary technology would, of course, normally lead to litigation and the awarding of damages or an injunction—which would discourage adoption of the standard. The RAND commitment was created to overcome the risks implementers face in adopting the standard and balance the loss of the patent holder’s right to exclude with reasonable royalty rates.

#### B. STANDARD-ESSENTIAL PATENTS AND THE RAND COMMITMENT

The process of developing standards varies depending on the SSO. Most SSOs require their members to disclose any patents or pending patent applications that might be relevant to the standard prior to adoption.<sup>43</sup> SSO members must declare which of their patents are essential to the practice of the prospective standard and must agree to license any such essential patent on RAND terms.<sup>44</sup> By definition, patents are essential to the standard if the patent “is necessary to implement either an optional or mandatory provision of a standard.”<sup>45</sup> Importantly, SSOs themselves do not investigate into whether patents declared to SEPs really are essential to the standard.<sup>46</sup> This policy of self-declaration by patent holders, although no doubt practically necessary in terms of limited SSO resources, appears to result in over-declaration.<sup>47</sup>

A member’s decision to over-declare is, in a way, a guessing game. Typical buyer-seller negotiations involve assigning a value for the product

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IEEE, Letters of Assurance are required before adoption of the standard but not before drafting. *Id.*

43. See, e.g., *Letter of Assurance for Essential Patent Claims*, IEEE, [http://standards.ieee.org/about/sasb/patcom/loa-802\\_11-kpn-08Jan2013.pdf](http://standards.ieee.org/about/sasb/patcom/loa-802_11-kpn-08Jan2013.pdf) (last visited Feb. 6, 2014); *General Patent Statement and Licensing Declaration Form For ITU-T or ITU-R Recommendation*, ITU, [http://www.itu.int/dms\\_pub/itu-t/oth/04/04/T04040000010003PDFE.pdf](http://www.itu.int/dms_pub/itu-t/oth/04/04/T04040000010003PDFE.pdf) (last visited Feb. 6, 2014).

44. See Thomas F. Cotter, *The Comparative Law and Economics of Standard-Essential Patents and FRAND Royalties*, 22 TEX. INTELLECTUAL PROP. L.J. (forthcoming 2014) (manuscript at 4), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2318050](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2318050); see also IEEE BYLAWS, *supra* note 42, § 6.2.

45. *Microsoft Corp. v. Motorola Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233, at \*26 (W.D. Wash. Apr. 25, 2013).

46. Cotter, *supra* note 44, at 2.

47. See ROBERT A. MYERS, *Fairfield Res. Int’l, Inc., REVIEW OF PATENTS DECLARED AS ESSENTIAL TO LTE AND SAE (4G WIRELESS STANDARDS) THROUGH JUNE 30, 2009 7* (2010), available at [http://www.frlicense.com/LTE Final Report.pdf](http://www.frlicense.com/LTE%20Final%20Report.pdf) (studying the extent to which patents declared essential to the 3GPP 4G LTE standard are actually essential and finding that of the 210 patent families with declared SEPs, only 105 families actually contain a patent essential to the standard).

prior to purchase. Answering difficult and detailed questions of validity and value would be a huge expenditure for a business to endure each time it wished to monetize its patent portfolio, particularly in light of the patent holder's twenty-year exclusive right.<sup>48</sup> Furthermore, because engineers manage the standard-setting process, a business can send only the necessary engineers to SSOs to participate in the standards process, rather than a cadre of lawyers and expert witnesses to argue the value of the patent. This is economically efficient considering the cost of legal services and the possibility that the patents have no real commercial value.<sup>49</sup> Finally, if a patent has low economic value due to commercially viable alternatives, it would behoove the patent holder to have its technology incorporated into a standard and receive reasonable royalty fees from a wide licensee base.<sup>50</sup> All of these factors can push a member into declaring its patent as essential and committing to license its technology for royalty rates.

Royalty rates are the mechanism by which SSOs contractually incentivize participation in the standard in order to advance adoption of the standard and thereby increase interoperability.<sup>51</sup> In exchange for reasonable royalty rates, essential patent holders must promise, in either an individually written letter or in a form Letter of Assurance ("LOA"), to license to any implementer for a reasonable royalty rate prior to their official inclusion into the standard.<sup>52</sup> Conversely, the implementer obtains a legal way to use proprietary technology in exchange for a reasonable sum of money and without the risk (ideally) of infringement accusations.<sup>53</sup> The question then

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48. See Doug Lichtman, *Understanding the RAND Commitment*, 47 HOUS. L. REV. 1023, 1028 (2010).

49. *Id.* at 1029.

50. It should be noted from a practical standpoint that there might be a simple element of the unknown in over-declaration. At the time a standard is being developed, the SSO member may have a patent application under prosecution but not an issued patent with set claims. Additionally, the standard itself may still be in flux, so what may be declared essential in one week may not be essential at the time the standard is actually implemented.

51. Section 8.1 of the IEEE's policies outlines its objective "[t]o develop and publish broadly accepted standards and other standards-related documents that will advance the theory and practice of electrical engineering, electronics, computer science." IEEE, IEEE POLICIES § 8.1 (2014), available at [http://www.ieee.org/documents/ieee\\_policies.pdf](http://www.ieee.org/documents/ieee_policies.pdf) [hereinafter IEEE POLICIES].

52. Should patent holders decline to give licensing assurances, the technology will not be incorporated into the standard. See, e.g., *ITU Common Patent Policy*, *supra* note 23.

53. The RAND commitment also reduces the risk of antitrust litigation. See Jon Leibowitz, Chairman, Fed. Trade Comm'n, Opening Remarks as Prepared for Delivery in *In the Matter of Motorola Mobility LLC and Google, Inc.* 3 (Jan. 3, 2013), in Respondent Apple Inc.'s Notice of New Authority and New Facts Relevant to Issues on Review at 10, *In re Certain Elec. Devices, Including Wireless Commc'n Devices, Portable Music Data Processing Devices, & Tablet Computers*, No. 337-TA-794 (U.S.I.T.C. May 22, 2013), 2013 WL



arises: does the patent holder, by making such a promise, not just weaken its exclusive right, but relinquish it altogether?

Logically, the answer is yes. If the purpose of the SSO is to ensure widespread adoption of a standard, the agreement to license on RAND terms is a statement that the patent can and *will* be licensed to any implementer on reasonable terms. The simple language of the commitment leaves little, if any, wiggle room.<sup>54</sup> Letters of Assurance may be one of the simplest contracts in intellectual property.

However, the simple format of the LOA does not provide much assistance in interpreting the contract. Like much of contract law, the question boils down to one of reasonableness. What is “reasonable”? Who determines reasonableness? How is reasonableness determined? These are all questions that the contract itself does not answer and whose answers are discussed further in Part III of this Note.<sup>55</sup> However, underlying this discussion of “reasonable” are policy concerns that have arisen, particularly in the contexts of the Smartphone Wars.

### C. “THE SMARTPHONE WARS” AND INCREASED SCRUTINY ON SEP LITIGATION

The scrutiny on standard-essential patent litigation has dramatically increased in recent years. In 2011, every major smartphone maker was embroiled in litigation at the ITC or federal courts.<sup>56</sup> Although the high stakes of patent infringement litigation should have been removed from

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2453722 (stating that “commitments to make patents available on reasonable terms matter and . . . companies cannot make those commitments when it suits them—that is, to have their patents included in a standard and then behave opportunistically later, once the standard is in place and those relying on it are vulnerable to extortion”).

54. For example, the IEEE form Letter of Assurance asks that the patent holder check one of four boxes. The first states that the SEP holder will grant licenses without compensation. The second option is the RAND commitment. The third is a promise that the SEP holder without conditions will not enforce any present or future SEP claims against any implementer. And the fourth option provides that the patent holder is not willing to either grant licenses or refrain from enforcing its patents, at which point its technology would not be incorporated into the standard. See *Letter of Assurance for Essential Patent Claims*, IEEE, <http://grouper.ieee.org/groups/1788/Patents/letter-of-assurance-form.pdf> (last visited Feb. 6, 2014).

55. See *infra* Part III.

56. Sam Favate, *Patent Trolls And Smartphone Wars Mean More Litigation—Survey*, WALL ST. J. (Dec. 1, 2011, 11:55 AM), <http://blogs.wsj.com/law/2011/12/01/patent-trolls-and-smartphone-wars-mean-more-litigation-survey>. The numerous patent infringement lawsuits that smartphone manufacturers have brought against each other as part of the business competition for the smartphone market gave rise to the moniker “The Smartphone Wars.” LLOYD, SPIELTHENNER & MOKDSI, *supra* note 10, at 4.

RAND licensing negotiations, patent portfolios are rarely neatly divided between SEPs and non-SEPs. RAND licensing negotiations often involve agreements, or demands even, for cross-licensing of an implementers non-SEPs in exchange for licensing royalty rates for the SEP holders technology.<sup>57</sup> In the intense competition over the smartphone market, SEPs became not only a tool with which SEP holders could gain access to non-SEP technology in cross-licensing, but a “strategic policy weapon.”<sup>58</sup>

Strategic use of SEPs started primarily as a defensive weapon.<sup>59</sup> For example, if Apple sued Google for patent infringement of the iPhone design patent, Google could then leverage its SEPs for the 802.11 Wi-Fi Standard (should Apple not yet have a license to those SEPs) as a basis to either force Apple to cross-license or threaten Apple with an injunction for infringement of the SEPs should litigation continue. This type of behavior has focused scrutiny on three primary policy concerns underlying SEPs: patent holdup, royalty stacking, and injunctive relief.<sup>60</sup> These concerns are briefly addressed and are meant to be illustrative rather than comprehensive.

Although adoption of an SSO standard is “voluntary” in theory, actual market pressures tip the scales considerably towards compulsory adoption of SSO standards in practice. Implementation of some standards, such as the 802.11 WLAN Standard,<sup>61</sup> is absolutely necessary to the commercial viability of certain products, even if the standard makes up only a small portion of the products. Because implementation is essentially required to compete in the market, SEP holders are able to extract royalties from implementers beyond the actual economic value added by the SEP.<sup>62</sup> This gap between technological added value and the ultimate royalty extracted is at the core of “patent holdup.”<sup>63</sup> Post-adoption, owners of SEPs gain substantial negotiating power and corresponding patent value “as a result of an adoption decision itself that is not directly related to the incremental value of the

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57. Dan O'Connor, *Standard-Essential Patents in Context: Just a Small Piece of the Smartphone War Puzzle*, PATENT PROGRESS (Mar. 5, 2013), <http://www.patentprogress.org/2013/03/05/standard-essential-patents-in-context-just-a-small-piece-of-the-smartphone-war-puzzle/> (stating that large companies often forgo cash payments for their SEPs in exchange for cross-licensing agreements).

58. *Id.*

59. *Id.*

60. *Id.*

61. The 802.11 WLAN Standard is a Wi-Fi standard and allows for companies to build products to a set of specifications for wireless local area networking. *See infra* Section III.B.4.

62. *See* Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 1993 (2007).

63. *Id.*

technology.”<sup>64</sup> It was this initial fear of patent holdup that the RAND commitment was meant to ameliorate.<sup>65</sup>

The fear of patent holdup is compounded when a manufacturer creates a single, multi-component device that requires implementation of multiple SEPs and, as a result, must pay multiple royalties to the owner(s).<sup>66</sup> This scenario, known as “royalty stacking,” is a problem for implementers on two levels. The first is simple arithmetic. Hypothetically, an implementer’s royalty fees could exceed the price at which the product could viably be sold, resulting either in infringement or withdrawal from the market.<sup>67</sup> Second, the stacked royalty rate is not simply the sum of the individual royalty rates for each patent holder.<sup>68</sup> Royalty rates are not negotiated in a vacuum. Royalty rates paid to one SEP holder significantly influence the negotiations of other royalty rates, causing the stacked royalty rate to be the sum of multiple inflated rates and higher than the true economic value.<sup>69</sup>

More recently, these concerns have been augmented by the possibility of injunctive relief. The threat of injunctions grants an SEP holder significant leverage to set royalty rates from an implementer, most dramatically where the SEP covers only one small component of a multi-component, profitable product.<sup>70</sup> This leverage would have been largely eliminated by the Supreme Court’s ruling in *eBay, Inc. v. MercExchange L.L.C.*,<sup>71</sup> if not for the continuing vitality of injunctions from the International Trade Commission (“ITC”).

In *eBay*, the Court set higher standards for granting injunctive relief.<sup>72</sup> The *eBay* requirement that monetary damages be inadequate to remedy the harm, coupled with the RAND commitment to license, in theory, effectively rules

64. James Ratliff & Daniel L. Rubinfeld, *The Use and Threat of Injunctions in the RAND Context*, 9 J. COMPETITION L. & ECON. 1, 3 (2013).

65. See, e.g., *ITU Common Patent Policy*, *supra* note 23.

66. This situation is the norm in the technology world, with devices like computers, smartphones, tablets, and gaming systems.

67. Unlike in non-SEP cases, design-around is not an option. Because standards require manufacturers to use certain technologies, manufacturers cannot practically design around a standard, as a lack of interoperability would make the product practically worthless.

68. Lemley & Shapiro, *supra* note 62, at 2011.

69. *Id.*

70. *Id.* at 1995.

71. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006); see Benjamin Peterson, *Injunctive Relief in the Post-eBay World*, 23 BERKELEY TECH. L.J. 193, 193 (2008) (stating that in *eBay* the Court significantly reduced the frequency with which injunctions can be granted).

72. Under the *eBay* test, to obtain injunctive relief, a plaintiff must prove: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction. *eBay*, 547 U.S. at 391–97.

out injunctive relief in the SEP litigation context.<sup>73</sup> However, as a result of its distinctive statutory/institutional regime, the ITC authorizes exclusion orders under a more lax standard than district courts apply in assessing injunctive relief, thus allowing a forum for SEP holders to seek injunctions against SEP implementers.<sup>74</sup>

## II. CREATING AN ENFORCEMENT MECHANISM: THE ROLE OF CONTRACT LAW IN *MICROSOFT V. MOTOROLA*

Due to the promissory nature of the LOA, SSO members inevitably turned to contract law to enforce the RAND commitment. The use of injunctive relief and exclusion orders increasingly resulted in calls for policy change regarding SEPs.<sup>75</sup> This Part examines how *Microsoft*, bolstered by subsequent rulings, demonstrates that contract law is the enforcement mechanism the RAND commitment has lacked by looking at judicial determinations of contract formation, third-party beneficiary status, the implied duty of good faith and fair dealing, and injunctive relief.<sup>76</sup>

### A. INTRODUCTION

Microsoft filed a breach of contract suit in November 2010, after receiving from Motorola two letters offering to license the 802.11 Standard

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73. See, e.g., Farrel et al., *supra* note 28, at 638; Lemley, *supra* note 7, at 1967; Lichtman, *supra* note 48, at 1023 n.6; Joseph Miller, *Standard-Setting, Patents, and Access Lock-in: RAND Licensing and the Theory of the Firm*, 40 IND. L. REV. 351, 358 (2007).

74. Peterson, *supra* note 71, at 215. In particular, concern arose in regards to these more lax standards due to non-practicing entities (“NPEs”) turning to the ITC to pursue patent remedies. See Colleen Chien, Patent Trolls by the Numbers 6 (Mar. 13, 2013), available at <http://digitalcommons.law.scu.edu/facpubs/609>. Additionally, the Obama administration expressed concern over exclusion orders granted by the. See Letter from Michael Froman, U.S. Trade Representative, to The Honorable Irving A. Williamson, Chairman, Int’l Trade Comm’n (Aug. 3, 2013), available at <http://pub.bna.com/ptcj/FromanITCreversal13Aug3.PDF> [hereinafter Presidential Veto] (vetoing the exclusion order barring Apple from importing devices that infringe essential patents held by Samsung and citing concern over “undue leverage” gained through the threat of an exclusion order).

75. See, e.g., The Innovation Act, H.R. 3309, 113th Cong. (2013) (giving the FTC authority to regulate unfair licensing demands). The bill has since passed the House and is up for debate in the Senate. *Id.*

76. The conception of SSO’s IP rules as contractually binding on SSO members has been articulated in academic literature since at least 2002. See Lemley, *supra* note 7, at 1909–17. At that time, there was no case law using contract theory to enforce the RAND commitment. Contract law was once again discussed as a possible enforcement mechanism in SEP litigation with the rise of the smartphone wars, and *Microsoft* provided the first final judgment of a full, breach of contract RAND action.

and the H.264 Standard.<sup>77</sup> Microsoft argued that (1) Motorola's RAND commitment constituted a contract with the IEEE, (2) Motorola's RAND commitment constituted a contract with the ITU, (3) that Microsoft was a third-party beneficiary to these contracts, and (4) that Motorola breached its contractual obligation to license on RAND terms by making blatantly unreasonable offers and by seeking injunctive relief.<sup>78</sup>

On September 4, 2013, the jury found that (1) Motorola breached its contractual commitment to the IEEE, (2) Motorola breached its contractual commitment to the ITU, (3) Motorola breached the implied duty of good faith and fair dealing in seeking injunctive relief with respect to its contractual obligations to the IEEE, and (4) Motorola breached the implied duty of good faith and fair dealing in seeking injunctive relief with respect to its contractual obligations to the ITU.<sup>79</sup> Although the jury ultimately determined that a breach had been committed, the court performed the majority of the contract analysis, including the threshold issue: Is the RAND commitment a contract?

#### B. THE THRESHOLD ISSUE: IS THE RAND COMMITMENT A CONTRACT?

The answer is yes.<sup>80</sup> Judge Robart's determination of the RAND commitment as a contract is not controversial in the legal academic community.<sup>81</sup> However, its importance lies in the fact that *Microsoft* is the first fully litigated breach of contract RAND action resulting in a RAND determination. On February 27, 2012, Microsoft received summary judgment in its favor on the issue of contract formation.<sup>82</sup> The court held that Motorola

77. *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 877 (2012).

78. *Id.* at 878.

79. Verdict Form at 2–3, *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 5398081 (W.D. Wash. Sept. 4, 2013).

80. *See Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1030 (W.D. Wash. 2012).

81. For academic articles regarding the contractual nature of the RAND commitment and the use of contract law as an enforcement mechanism, see, for example, Jorge L. Contreras, *Rethinking RAND: SDO-Based Approaches to Patent Licensing Commitments* (Oct. 10, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2159749](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159749); Thomas F. Cotter, *supra* note 44; Mark A. Lemley & Carl Shapiro, *A Simple Approach to Setting Reasonable Royalties for Standard-Essential Patents*, 28 BERKELEY TECH. L.J. 1135 (2013) [hereinafter Lemley & Shapiro, *A Simple Approach*]; Mark A. Lemley, *Ten Things to Do About Patent Holdup of Standards (And One Not To)*, 48 B.C. L. REV. 149 (2007) [hereinafter Lemley, *Ten Things to Do*]; Lichtman, *supra* note 48; Ratliff & Rubinfeld, *supra* note 64.

82. *Microsoft Corp. v. Motorola, Inc.* 854 F. Supp. 2d 993, 1002–04 (W.D. Wash. 2012).

entered into binding contractual commitments with the IEEE and the ITU by committing to license its SEPs on RAND terms.<sup>83</sup>

Motorola had contended that Motorola's commitments to the IEEE and ITU were unilateral offers to grant licenses on RAND terms.<sup>84</sup> Motorola argued that implementers, "if they satisfy the conditions to apply for a license in some form and negotiate, are entitled to the license."<sup>85</sup> Motorola understood LOAs as creating a contract between the SEP holder and the *licensee* once the licensee has applied for a license and negotiated with the SEP holder.<sup>86</sup>

This conception of the LOA as a unilateral offer twists the original purpose of the RAND commitment. In the RAND context, the standard itself ensures that the implementer cannot choose an alternate technology to incorporate. To transform the conception of the RAND commitment as a contract between an SEP holder and an SSO into a conception of the RAND commitment as a unilateral offer between an SEP holder and an implementer increases the problem of unequal bargaining power. SEP holders would have the ability to set any price they wish and have no obligation to negotiate with implementers. Because such unequal bargaining power is contrary to the purposes of the RAND commitment, the court correctly rejected Motorola's unilateral offer theory and reaffirmed that the LOA forms a contract between the SEP holder and the SSO.<sup>87</sup>

Of course, contract formation requires an offer, acceptance, and consideration.<sup>88</sup> First, upon learning that a standard incorporates a privately held patent, the IEEE and ITU request an LOA from the SEP holder to state its intention either not to enforce its patent, to license on RAND terms, or to decline incorporation into the standard.<sup>89</sup> The court found that the requests for assurance constituted offers to the patent holder so that the SSO can choose whether to incorporate the patented technology into the standard.<sup>90</sup> The court then concluded that Motorola's LOAs to the IEEE and ITU "constitute acceptances for purposes of contract formation . . . [b]y

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83. *Id.*

84. *Id.* at 1030.

85. *Id.* at 1031.

86. *Id.*

87. *Id.* This ruling is not without precedent. *See, e.g.,* Research in Motion Ltd. v. Motorola, Inc., 644 F. Supp. 2d 788, 797 (N.D. Tex. 2008), *Ericsson Inc. v. Samsung Elecs. Co.*, No. 2:06-CV-63, 2007 WL 1202728, at \*1 (E.D. Tex. Apr. 20, 2007).

88. *Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1031 (W.D. Wash. 2012).

89. *Id.* For the language used by the IEEE and ITU, see *supra* note 43.

90. *Id.* at 1032. The court also noted that historically, the IEEE has not included technology in a standard for which it has not received an LOA. *Id.*

checking the box on both IEEE and ITU forms that it is willing to grant licenses on RAND terms.”<sup>91</sup> The final element—consideration—was met by the SSOs’ promise to include, or to consider including, the patented technology in exchange for Motorola’s promise to license on RAND terms.<sup>92</sup> In light of valid offer, acceptance, and consideration, the court held that Motorola’s promises to the IEEE and ITU to license its SEPs on RAND terms were binding contracts.<sup>93</sup>

### C. THIRD-PARTY BENEFICIARY STATUS: THE NECESSARY ELEMENT

Holding that the RAND commitment constituted a legally enforceable promise provided a cause of action to implementers. However, implementers still needed the ability to enforce the RAND contract. In answering this need, the court turned to Microsoft’s status as a third-party beneficiary.<sup>94</sup> A third-party beneficiary, though not party to a contract, is able to sue upon a contract if the contract was for the third-party’s direct benefit.<sup>95</sup> The question became whether the RAND commitment was for the potential licensees’ benefit.<sup>96</sup>

Judge Robart noted that the benefit of the RAND commitment was for implementers, stating that “[t]hese commitments are clearly designed to benefit potential licensees of Motorola’s standard essential patent by ensuring that such patents are readily accessible to everybody at reasonable rates.”<sup>97</sup> The court held that, as a member of the IEEE and ITU and as a potential user of the 802.11 and H.264 Standards, Microsoft “is a third-party

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91. *Id.*

92. *Id.*

93. *Id.* Judge Robart’s holding has since been echoed in subsequent cases. In *Realtek Semiconductor Corp. v. LSI Corp.*, citing *Microsoft*, Judge Whyte stated “[t]here is no dispute in this case that [LSI] entered into a binding contract with the IEEE to license their declared standard essential patents.” 946 F. Supp. 2d 998, 1005 (N.D. Cal. 2013). *See also In re Innovatio IP Ventures, LLC*, MDL No. 2303, No. 11-C-9308, 2013 WL 3874042, at \*4 (N.D. Ill. July 26, 2013) (noting that the “parties do not dispute that the letters . . . to the IEEE constitute binding contractual commitments to the IEEE and its members); *Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061, 1084 (W.D. Wis. 2012) (holding that Motorola’s promise to license on RAND term constituted a binding contract). Of course, this spate of recent decisions is not without precedent. The RAND commitment has also been judicially held in earlier decades to be a valid contract. *See, e.g., ESS Technology, Inc. v. PC-Tel, Inc.*, No. C-99-20292, 1999 WL 33520483, \*4 (N.D. Cal. Nov. 4, 1999) (holding that the software manufacturer had a properly stated claim for specific performance of a contract requiring the defendant to license patents on nondiscriminatory and reasonable terms).

94. *Microsoft*, 864 F. Supp. 2d at 1032.

95. *Id.*

96. *Id.* at 1033.

97. *Id.*

beneficiary of Motorola's commitments to the IEEE and ITU," and is therefore entitled to sue for breach of the RAND contract.<sup>98</sup> This holding provided implementers with an enforcement mechanism to the RAND commitment.

Motorola, in its cross-claims, argued that Microsoft's rights as a third-party beneficiary were conditioned upon Microsoft (1) applying for a license and (2) negotiating for a RAND license to those patents.<sup>99</sup> Motorola then argued that, since Microsoft had failed to meet the two conditions precedent, Microsoft had repudiated any rights to a RAND license.<sup>100</sup> The court rejected this argument.<sup>101</sup> After examination of the IEEE and ITU policies, the court held that it was not the intent of Motorola and the IEEE or ITU to require an implementer of a standard to first apply for and negotiate a license as conditions precedent to Motorola's RAND obligations.<sup>102</sup>

Although an SSO could hypothetically choose to include such conditions precedent in its RAND commitments, such conditions are contrary to the purposes of RAND in multiple respects. First, requiring potential implementers to first apply for and negotiate a RAND license in order to be recognized as a third-party beneficiary would slow innovation. Licensing discussions are lengthy and complicated. If a licensee were unable to implement the standard until a RAND rate had been negotiated, adoption of the standard would be slowed or disincentivized.<sup>103</sup> Second, the terminology of "apply for" is problematic because it implies the possibility of a refusal to license. RAND licensing, by its nature, must be available to any implementer. Finally, requiring implementers to apply and negotiate for a RAND license before the SEP holder has any affirmative obligation to license weakens the enforcement mechanism that contract law offers. In this case, had Microsoft been required to apply and negotiate first, Motorola would have been able to skirt its commitments to the IEEE and ITU simply by preemptively contacting Microsoft before it had applied, thus negating Motorola's RAND commitments.<sup>104</sup>

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98. *Id.* at 1032–33.

99. *Id.* at 1033.

100. *Id.* at 1034.

101. *Id.* at 1033–34.

102. *Id.* at 1034 (“The court is disinclined to find that either applying for a license or negotiating in good faith are conditions precedent.”).

103. This may also lead to antitrust concerns for the SEP holder, opening them to accusations of suppressing competition by submitting companies to lengthy negotiations or denying implementers access to the standard at all.

104. *Id.* at 1035. Motorola also argued that Microsoft had repudiated its third-party rights by filing a breach of contract action. *Id.* The court stated that it “will not find that



D. THE DUTY OF GOOD FAITH AND FAIR DEALING: A NEW STANDARD?

The next step in using contract law as an enforcement mechanism for the RAND commitment is establishing the standard for breach of contract. The jury in *Microsoft* used the duty of good faith and fair dealing as the standard for breach of contract.<sup>105</sup> Because market pressures often force implementers to adopt a standard and implement patented technology, acting in good faith becomes paramount to RAND royalty negotiations. To allow SEP holders to institute negotiations without a standard of conduct would permit them to take advantage of implementers' required participation, leading to undue leverage in negotiations.

In *Microsoft*, Motorola challenged the use of the duty of good faith and fair dealing as a standard for finding a breach contract because there is no "free floating" duty of good faith and fair dealing.<sup>106</sup> The court agreed but stated that there is a duty of good faith and fair dealing implied in every contract that arises out of fulfillment of contractual obligations.<sup>107</sup> Therefore, the implied duty of good faith and fair dealing stemmed from Motorola's LOAs and declarations to the IEEE and ITU to license on RAND terms.<sup>108</sup> The court instructed the jury that Motorola had an obligation to license its SEPs on RAND terms and that in moving towards a RAND license, Motorola had a duty to act in good faith and fair dealing.<sup>109</sup>

However, defining the duty of good faith and determining when it has been breached are challenging tasks. The court noted that there is no uniform definition of the implied duty of good faith and fair dealing.<sup>110</sup> Rather, the duty of good faith and fair dealing arises in context, and it is the province of the jury to determine whether the duty of good faith and fair dealing has been breached.<sup>111</sup>

The uncertainty and unpredictability surrounding the duty of good faith and fair dealing offers the possibility of rekindling negotiation. If standardization is based on RAND licensing, the negotiation process is a

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Microsoft has repudiated its rights to a RAND license by simply seeking court relief in attempting to enforce the terms of Motorola's [RAND] commitment." *Id.* at 1036.

105. Verdict Form at 3, *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 5398081 (W.D. Wash. Sept. 4, 2013).

106. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 138786, at \*34 (W.D. Wash. Sept. 24, 2013).

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* at \*5.

111. *Id.*

necessary part of that licensing. The duty of good faith and fair dealing removes the “take-it-or-leave-it” stance that seems inherent in outrageously high licensing demands and requires a baseline code of conduct and at least some actual negotiation. Additionally, some courts have taken the position that seeking injunctive relief prior to RAND negotiations is a breach of contract, though without invoking the duty of good faith and fair dealing as a standard.<sup>112</sup>

E. THE RAND COMMITMENT AND THE PROPRIETY OF INJUNCTIVE RELIEF

Much of the discussion of this Note has been circling around the propriety of injunctive relief in the RAND context. Concerns over injunctive relief are present in concerns over undue leverage and patent holdup, subjects of much academic consideration.<sup>113</sup> And although injunctive relief is never desirable to an implementer, an SEP holder seeking injunctive relief does provide an immediate harm that the implementer can use to bring a breach of contract action and enforce the SEP holder’s RAND commitment.

1. *The eBay Factors in the RAND Context*

Under *eBay*, in order to obtain injunctive relief a plaintiff must prove: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.<sup>114</sup>

Under the logic of *eBay*, injunctive relief in the RAND context is inappropriate. First, the SEP holder has not suffered an irreparable injury.

112. In *Realtek Semiconductor*, Judge Whyte held:

[D]efendants breached their contractual obligations to IEEE and to Realtek as a third-party beneficiary of that contract by seeking injunctive relief against Realtek before offering Realtek a license. The court’s breach of contract holding is limited to the situation here, where defendants did not even attempt to offer a license, on “RAND” terms or otherwise, until after seeking injunctive relief. This conduct is a clear attempt to gain leverage in future licensing negotiations and is improper.

*Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998, 1008 (N.D. Cal. 2013).

The court’s discussion of an “improper” and “clear attempt to gain leverage” seems to invoke the notion of breaching the duty of good faith and fair dealing that is inherent within every contract. *Id.*

113. See, e.g., Lemley, *Ten Things to Do*, *supra* note 81, at 158 (advocating for a system that takes injunctive relief “off the table” for standard-essential patents).

114. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006).

The SEP holder has agreed to exchange its exclusive right to the market for its particular technology in exchange for reasonable royalty rates; therefore, an implementer's use of patented technology cannot constitute an irreparable injury.<sup>115</sup> Second, monetary damages in the RAND context are completely adequate for any injury. Again, the SEP has *already* committed to exchanging its proprietary technology in exchange for royalty rates. Monetary damages are the precise remedy that would be applied to an SEP situation. Finally, injunctive relief is inappropriate because the public interest is disserved by a permanent injunction. As previously discussed, standardization and implementation provide many benefits for consumers, including greater product competition, interoperability of products, and lower prices.<sup>116</sup> If injunctions are granted at will, adoption of standards will be disincentivized, decreasing interoperability and harming consumers.

## 2. Microsoft v. Motorola: *A Narrowed Question*

In July of 2011, after the litigation in Washington began, Motorola filed for injunctive relief in Germany against certain Microsoft products, including the Xbox.<sup>117</sup> In May of 2012, the German court granted the injunction.<sup>118</sup> Microsoft then filed an action in the District Court for the Western District of Washington seeking to enjoin Motorola from enforcing the German injunction.<sup>119</sup> While deciding to enjoin Motorola from enforcing the German injunction, Judge Robart also noted that there is “jurisprudential debate about the availability of injunctive relief to enforce SEPs.”<sup>120</sup>

The Ninth Circuit, in upholding Judge Robart's ruling, suggested that injunctive relief is not appropriate in the RAND context.<sup>121</sup> Although it is likely dicta, the court stated, “injunctive relief against infringement is arguably a remedy inconsistent with the licensing commitment.”<sup>122</sup> The Ninth Circuit also noted that Motorola's declaration to the ITU to license on RAND terms is a sweeping promise that implies “a guarantee that the patent-holder will not take steps to keep would-be users from using the patented material, such as seeking an injunction, but will instead proffer licenses consistent with the

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115. For a fuller discussion of these factors, see *id.*

116. See *supra* Section I.A.

117. Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 879 (9th Cir. 2012).

118. *Id.*

119. *Id.* at 875.

120. Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2013 U.S. Dist. LEXIS 138786, at \*33 (W.D. Wash. Sept. 24, 2013).

121. *Microsoft*, 696 F.3d at 872.

122. *Id.* at 885.

commitment made.”<sup>123</sup> Finally, the Ninth Circuit noted that skepticism of injunctive relief was expressed by Justice Kennedy in his concurrence in *eBay*, stating that injunctions “‘may not serve the public interest’ in cases where ‘the patented invention is but a small component of the product the companies seek to produce and the treat of an injunction is employed simply for undue leverage in negotiations.’”<sup>124</sup>

In September 2013, the jury in the district court returned a verdict finding that Motorola’s actions in seeking injunctive relief violated its duty of good faith and fair dealing.<sup>125</sup> Despite the Ninth Circuit’s unfavorable view of injunctions in the RAND context, the district court took a cautious approach in its jury instructions and “did not instruct the jury that Motorola had waived its right to seek injunctive relief.”<sup>126</sup> Rather, the jury instructions stated that Motorola had a contractual obligation to license its SEPs on RAND terms and that, in doing so, Motorola was required to comply with the duty of good faith and fair dealing.<sup>127</sup> The jury would then determine if Motorola had violated the duty of good faith and fair dealing by seeking injunctive relief in light of the ongoing litigation and its RAND commitment.<sup>128</sup> By refusing to grant summary judgment on the issue of injunctive relief and making it a jury question, the court removed itself from a policy debate and narrowed the question to Motorola’s behavior in the context of this particular case.<sup>129</sup>

Since *Microsoft*, courts have addressed the appropriateness of injunctive relief in the RAND context. In *Realtek Semiconductor Corp. v. LSI Corp.*, the

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123. *Id.* at 885.

124. *Id.* at 877 (quoting *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 396–97 (2006) (Kennedy, J., concurring)).

125. Verdict Form at 3, *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 WL 5398081 (W.D. Wash. Sept. 4, 2013).

126. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 138786, at \*33 (W.D. Wash. Sept. 24, 2013).

127. *Id.*

128. *Id.* However, in its November 30, 2012, Order dismissing Motorola’s request for injunctive relief in the district court action, the court held that injunctive relief is an inappropriate remedy because “Motorola has not shown it has suffered an irreparable injury or that remedies available at law are inadequate to compensate for its injury.” *Microsoft Corp. v. Motorola Inc.*, No. C10-1823JLR, 2012 WL 5993202, at \*7 (W.D. Wash. Nov. 30, 2012).

129. However, when enjoining Motorola from enforcing their German injunction against Microsoft, Judge Robart stated that the district court’s preliminary injunction would remain in effect until the court was “able to determine whether injunctive relief is an appropriate remedy for Motorola to seek with respect to Microsoft’s alleged infringement of Motorola’s standard essential patents.” *Microsoft Corp. v. Motorola, Inc.*, 871 F. Supp. 2d 1089, 1100, 1104 (W.D. Wash. 2012).

issue presented was whether an SEP holder filing a Section 337 action—an exclusion order—at the ITC against an implementer is a per se breach of the SEP holder’s RAND commitment.<sup>130</sup> Realtek sought an order prohibiting LSI from enforcing or seeking to enforce any exclusion or injunction that the ITC might issue with respect to SEPs pending a full “RAND trial” on the merits.<sup>131</sup> The court held that the act of seeking injunctive relief before proposing a RAND license was “inherently inconsistent and a breach of the defendants’ promise to license the patent on RAND terms.”<sup>132</sup> Invoking the *eBay* factors, the court noted that a “RAND royalty would be adequate compensation for any injury [LSI] has suffered as a result of Realtek’s allegedly infringing conduct.”<sup>133</sup> Additionally, the court noted that Realtek was harmed because the threat of an exclusion order gives the SEP holder inherent undue bargaining power in any negotiations that take place.<sup>134</sup>

In *Apple, Inc. v. Motorola, Inc.*, Judge Posner considered the appropriateness of injunctive relief in the RAND context and determined that “the court would not be justified in enjoining Apple from infringing unless Apple refuses to pay a royalty that meets the [RAND] requirement.”<sup>135</sup> Finally, in *In re Innovatio IP Ventures*, the court did not take a position on injunctive relief but noted that its removal as an available remedy would not unduly burden the SEP holders, as they voluntarily made the RAND commitment.<sup>136</sup> Although there is not yet a judicial consensus on the propriety of injunctive relief in the RAND context, it is increasingly disfavored. In *Realtek*, an ITC exclusion order itself triggered the breach of contract, resulting in the court holding that seeking an exclusion order in the ITC prior to offering a RAND royalty rate is a per se breach of contract.<sup>137</sup> The view that injunctive relief is inconsistent with the RAND commitment makes seeking injunctive relief a harm that an implementer can then bring a breach of contract action to remedy.

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130. *Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998, 1000–01 (N.D. Cal. 2013).

131. *Id.* at 1001.

132. *Id.* at 1006.

133. *Id.* at 1007.

134. *Id.*; see also U.S. DEPT. OF JUSTICE & U.S. PATENT & TRADEMARK OFFICE, JOINT POLICY STATEMENT ON REMEDIES FOR STANDARDS-ESSENTIAL PATENTS SUBJECT TO VOLUNTARY F/RAND COMMITMENTS 6 (2013), available at [http://www.uspto.gov/about/offices/ogc/Final\\_DOJ-PTO\\_Policy\\_Statement\\_on\\_FRAND\\_SEPs\\_1-8-13.pdf](http://www.uspto.gov/about/offices/ogc/Final_DOJ-PTO_Policy_Statement_on_FRAND_SEPs_1-8-13.pdf).

135. *Apple, Inc. v. Motorola, Inc.*, 869 F. Supp. 2d 901, 2012 (N.D. Ill. 2012).

136. *In re Innovatio IP Ventures, LLC Patent Litig.*, MDL 2303, 2013 WL 5593609, at \*11 (N.D. Ill. Oct. 3, 2013).

137. *Realtek*, 946 F. Supp. 2d at 1010.

## F. CONCLUSION

The lack of an enforcement mechanism for the RAND commitment made the emergence of contract law into SEP litigation inevitable. Alternatives to contract law have been proposed as possible solutions to the problem of SEP litigation, but these alternatives often involve significant policy shifts or the cooperation of standard-setting organizations.<sup>138</sup> The reality of the current legal field, where SEP cases abound, requires a more immediate roadmap. Recent judicial rulings holding that (1) the RAND commitment is a valid contract, (2) implementers are third-party beneficiaries, (3) the introduction of the duty of good faith and fair dealing is a contractual standard in the RAND commitment, and (4) injunctive relief is incompatible in the RAND context, make contract law an attractive enforcement mechanism. However, questions still remain as to what a reasonable royalty actually is, how is it determined, and by whom it is determined. Emerging answers to these remaining questions will be discussed in Part III.

## III. THE DETERMINATION OF REASONABLE: THE MICROSOFT METHOD

As Mark Lemley has noted, “While reasonable and nondiscriminatory licensing thus appears to be the majority rule among SSOs with a patent policy, relatively few SSOs gave much explanation of what those terms mean or how licensing disputes would be resolved.”<sup>139</sup> In fact, many prominent SSOs explicitly deny responsibility in answering these questions.<sup>140</sup> And it is these questions as to the meaning of “reasonable” that are currently before federal judges.

Despite years of academic and professional debate on what constitutes reasonable terms, there had never been a judicially determined RAND royalty rate.<sup>141</sup> Judge Robart’s RAND rate determination in *Microsoft* was the first of its kind.<sup>142</sup> His methodology is detailed, but familiar. It utilizes the *Georgia-*

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138. These alternatives will be explored more fully in Section IV.A, *infra*.

139. Lemley, *supra* note 7, at 1906.

140. *See, e.g.*, IEEE BYLAWS, *supra* note 42, § 6.2 (“The IEEE is not responsible for determining whether any licensing terms or conditions provided . . . in any licensing agreements are reasonable or nondiscriminatory.”).

141. *See, e.g.*, Lichtman, *supra* note 48.

142. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233 (W.D. Wash. Apr. 25, 2013).

*Pacific* factors used in patent damages calculations,<sup>143</sup> modifying them to specifically address SEP and RAND contexts and concerns.<sup>144</sup> This Part examines how the contractual analysis in *Microsoft* formulated the issue of reasonableness in a RAND license. It also examines Judge Robart's method of calculation and the subsequent RAND royalty rate calculation in *In re Innovatio*. Finally, this Part argues that although judicially determined RAND rates are not ideal, the availability of their determination in a contractual analysis provides a necessary remedy for the RAND commitment.

#### A. MICROSOFT V. MOTOROLA AND REFORMULATING REASONABLE

The *Microsoft* litigation began with an assertion that offers to license had to be made on RAND terms.<sup>145</sup> Microsoft alleged that Motorola's offer letters breached Motorola's RAND commitments to the IEEE and ITU by (1) requesting a royalty rate that resulted in "blatantly unreasonable" cash payments and (2) applying a "blatantly unreasonable" base—the sale price of Xboxes, computers, and smartphones running Windows.<sup>146</sup> However, Motorola argued that its RAND commitments only required Motorola to *issue* licenses on RAND terms, not make initial offers on RAND terms.<sup>147</sup>

The court found that the language of Motorola's LOAs to the IEEE and declarations to the ITU focused on a *resulting* RAND license.<sup>148</sup> The court reasoned that the policies of the IEEE and ITU, by stating that "[n]egotiations are left to the parties concerned,"<sup>149</sup> envision a negotiation between the parties resulting in a RAND license.<sup>150</sup> Because of this anticipated negotiation, it "logically does not follow that initial offers must be on RAND terms."<sup>151</sup> Critical to the court's determination was that if the court did not know what the RAND rate in the case was, how could the parties know what was reasonable at the time of offer?<sup>152</sup>

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143. See *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

144. *Microsoft*, 2013 U.S. Dist. LEXIS 60233, at \*54–65.

145. *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 879 (9th Cir. 2012) (discussing the injunctive relief granted to Motorola by the German courts).

146. *Microsoft Corp. v. Motorola Inc.*, 864 F. Supp. 2d 1023, 1036 (W.D. Wash. 2012).

147. *Id.* at 1037.

148. *Id.*

149. *ITU Common Patent Policy*, *supra* note 23.

150. *Microsoft*, 864 F. Supp. 2d at 1037.

151. *Id.* at 1038.

152. *Id.* Additionally, if courts required offers to be made on RAND terms, this would frustrate the purpose of ensuring broad access to SEPs and widespread adoption of standards. Patent holders would be disincentivized from participating in the standards

However, this interpretation did not entitle Motorola make blatantly unreasonable offers. The court held that SEP holders must comport with “the implied duty of good faith and fair dealing inherent in every contract,”<sup>153</sup> and that before a jury could decide whether Motorola’s licensing offers breached the duty of good faith, the court would “need to determine a true RAND royalty rate for purposes of comparison.”<sup>154</sup> In order to accomplish this, a bench trial was held to determine a RAND range and specific rate for Motorola’s SEPs in the 802.11 and H.264 Standards.<sup>155</sup>

#### B. REACHING A REASONABLE RATE IN MICROSOFT

Following the bench trial, Judge Robart set forth a methodology for determining a RAND royalty rate and range. The methodology adopts a modified version of the *Georgia-Pacific* factors in order to recreate a hypothetical negotiation between an SEP holder and an implementer.<sup>156</sup> The *Microsoft* framework has two central considerations in its analysis: in a hypothetical negotiation the parties would set RAND royalty rates by evaluating (1) the importance of the SEPs to the standard, and (2) the importance of the standard and the SEPs to the products at issue.<sup>157</sup>

The importance of the SEPs to the standard and the importance of the standard and the SEPs to the products at issue define a “reasonable” rate. Judge Robart also outlined “economic guideposts for assessing RAND terms,” stating that (1) creating a RAND rate should take into consideration and seek to mitigate patent holdup and royalty stacking, (2) that a reasonable royalty should be limited to the value of the patented technology *apart* from the value associated with incorporation into the standard and, (3) that the SEP holder should receive a reasonable return on its investment.<sup>158</sup> These economic guideposts reduce the problem of outrageously high RAND royalty demands by anchoring the RAND rate to the value of the contribution rather than the holdup value.

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process for fear that they would be required to make reasonable offers or risk being sued for breach of contract.

153. *Microsoft*, 864 F. Supp. 2d at 1038.

154. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 WL 5993202, at \*4 (W.D. Wash. Nov. 30, 2012).

155. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233 (W.D. Wash. Apr. 25, 2013).

156. *See Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

157. *Microsoft*, 2013 U.S. Dist. LEXIS 60233, at \*44.

158. *Id.* at \*43–44.



Judge Robart incorporated the economic guideposts into a hypothetical bilateral negotiation.<sup>159</sup> The court noted that this framework was preferable because bilateral negotiations are typical for most RAND negotiations, and because this framework was used in *Georgia-Pacific*.<sup>160</sup>

1. *A New Formulation of the Georgia-Pacific Factors*

As there had never been a judicially determined RAND royalty prior to *Microsoft*, there was no pre-existing framework with which to calculate a RAND royalty rate. The widely accepted use of the *Georgia-Pacific* factors to calculate patent royalties seemed a natural place to begin.<sup>161</sup> The court, however, noted critical differences between the *Georgia-Pacific* context and the RAND context.<sup>162</sup> First, where in the *Georgia-Pacific* framework the patent holder has monopoly power over its patent and may choose to withhold licensing, the SEP holder is under contractual obligation to license.<sup>163</sup> Second, in any negotiation, the implementer knows it will need to take a license from many SEP owners, rather than just a single owner.<sup>164</sup> In light of these differences, Judge Robart modified the *Georgia-Pacific* factors to the RAND context, emphasizing contribution over market value.<sup>165</sup>

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159. *Id.* at \*48. The court rejected Microsoft's multilateral hypothetical negotiation approach that framed the economic value of the patent as the incremental value of the technology compared to the alternatives that could have been written into the standard. *Id.* at \*44. The court stated that Microsoft's approach lacked real-world applicability and cited the difficulty courts would face in trying to determine the incremental value for multi-patent standards. *Id.* at \*44–46. The court did state that determining the value of the patent requires consideration of the importance and contribution of the patent to the standard. Any alternatives available to the patented technology that would have provided the same or similar technical contribution to the standard would help frame the actual value of the patent at issue. In this way, incremental value is a useful consideration. *Id.* at \*46.

160. *Id.* at \*50–51.

161. *See* *LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 60 n.2 (Fed. Cir. 2012) (stating that the use of the *Georgia-Pacific* factors to “frame the reasonable royalty inquiry . . . properly tie[s] the reasonable royalty calculation to the facts of the hypothetical negotiation at issue”); *see also* Anne Layne-Farrar et al., *Pricing Patents for Licensing in Standard Setting Organizations: Making Sense of FRAND Commitments*, 74 ANTITRUST L. J. 671, 673–81 (2007) (arguing that courts seeking to evaluate what behavior is consistent with the FRAND commitments can extend the *Georgia-Pacific* factors, most of which are directly applicable to FRAND evaluations).

162. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233, at \*53 (W.D. Wash. Apr. 25, 2013).

163. *Id.*

164. *Id.*

165. *Id.* at \*54–65.

2. *The Microsoft Modifications*<sup>166</sup>

<i>Georgia-Pacific</i> Factors	<i>Microsoft</i> Factors
1. The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.	1. To prove an established royalty rate for an SEP, the past royalty rates for a patent must be negotiated under a RAND, or comparable, negotiation; licensing agreements, such as patent pools, will be relevant.
2. The rates paid by the licensee for the use of other patents comparable to the patent in suit.	2. The rates paid by the licensee for the use of other patents comparable to the patent in suit.
3. The nature and scope of the license.	3. The nature and scope of the license.
4. The 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 to preserve that monopoly.	4. Inapplicable because the licensor has made a commitment to license on RAND terms and may no longer maintain a patent monopoly; an SEP owner must grant licenses on RAND terms to all implementers of the standard.
5. The commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business, or whether they are inventor and promoter.	5. Inapplicable because having committed to license on RAND terms, the patentee may no longer discriminate against its competitors; the patentee must license to all implementers on reasonable terms.
6. The effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.	6. 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.
7. The duration of the patent and the term of the license.	7. The term of the license is the term of the patent so this factor has little influence on a reasonable royalty rate.
8. The established profitability of the product made under the patent, its commercial success, and its current popularity.	8. Same considerations as <i>Microsoft</i> factor 6.

166. This chart is compiled for brevity's sake. For Judge Robart's full discussion of the factors, see *id.*

9. The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.	9. Alternatives that could have been written into the standard instead of the patented technology during the period before the standard was adopted and implemented. <sup>167</sup>
10. The nature of the patented invention, the character of the commercial embodiment of it as owned and produced by the licensor, and the benefits to those who have used the invention.	10. Contribution of the patent to the technical capabilities of the standard and the contribution of those relevant technical capabilities to the implementer's products, keeping the value of the technology separate from the value associated with incorporation into the standard; evidence of the benefit and value of the patent to the owner and implementer is relevant to the capability of the standard and contribution of the standard to the implementer.
11. The extent to which the infringer has made use of the invention, and any evidence probative of the value of that use.	11. Same considerations as <i>Microsoft</i> factor 10.
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.	12. The customary practices of businesses licensing RAND-committed patents; licensing fees for non-RAND-committed patents customary in the business industry cannot form the basis of comparison.
13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.	13. Contribution of the patented technology apart from the value of the patent as a result of its incorporation into the standard.
14. The opinion testimony of qualified experts.	14. The opinion testimony of qualified experts.
15. The amount that a licensor and licensee would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement.	15. The SEP owner's obligation 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 the avoidance of holdup and stacking.

The RAND-based modifications made to the *Georgia-Pacific* factors (hereinafter "*Microsoft* factors") focus heavily on the contribution of the SEPs to the standard, and on the importance of the standard and the SEPs to the

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167. This factor is an incremental valuation. See *supra* note 159 and accompanying text.

products at issue.<sup>168</sup> *Microsoft* factors 6, 8, 10, 11, and 13 are all focused on the contribution of the SEP to the standard.<sup>169</sup> As such, they weigh heavily in the court's determination of the RAND rates and ranges set for Motorola's SEPs pertaining to the H.264 and 802.11 Standards.

### 3. *Valuation of Motorola's SEPs Relating to the H.264 Standard*

There are over 2,500 patents essential to the H.264 Standard.<sup>170</sup> The standard is used for video compression, the process by which video data is formatted to require less memory.<sup>171</sup> Video compression is important due to the massive data storage capacity necessary for modern digital video.<sup>172</sup> A video compression standard defines many different coding tools used for different purposes, each of which contributes a small amount to the compression of the video.<sup>173</sup> Fourteen of Motorola's sixteen patents incorporated in the H.264 Standard relate almost entirely to "interlaced video," a compression technology surpassed by "progressive video" and rarely used in modern technology or Microsoft products.<sup>174</sup> In light of the vast majority of Motorola's patents being irrelevant to Microsoft's products at issue, the court set the RAND royalty rate for Motorola's H.264 SEP portfolio set at a mere 0.555 cents per unit.<sup>175</sup> The court also determined that a RAND royalty range for Motorola's H.264 SEP portfolio had an upper bound of 16.389 cents per unit and a lower bound of 0.555 cents per unit.<sup>176</sup>

These figures were calculated using the MPEG LA H.264 patent pool (*Microsoft* factor 1).<sup>177</sup> Patent pools are created to facilitate the licensing of SEPs to third-party licensees by eliminating the need to negotiate individually with different SEP owners.<sup>178</sup> Instead, the pools gather all the necessary SEPs in a single licensing package for third-party implementers.<sup>179</sup> Patent pools distribute royalties on a per patent basis as part of a patent-counting system.<sup>180</sup> Once the terms of a patent pool are set, a potential licensor cannot

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168. *Microsoft*, 2013 U.S. Dist. LEXIS 60233, at \*54–65.

169. *Id.*

170. *Id.* at \*80.

171. *Id.* at \*66.

172. *Id.*

173. *Id.*

174. *Id.* at \*68–69, 83.

175. *Id.* at \*20.

176. *Id.* at \*20.

177. *Id.* at \*239–42.

178. *Id.* at \*217.

179. *Id.*

180. *Id.* at \*218.

go to the pool and renegotiate the deal.<sup>181</sup> As a result, fundamental or broad patents are given the equivalent value as weak or narrow patents.<sup>182</sup> Patent pools are imperfect models because they tend to produce lower rates than those produced through bilateral negotiations, do not use the incremental value approach of *Microsoft* factor 9, and carry policy concerns of disincentivizing participation in standard setting.<sup>183</sup> Therefore the court concluded that the MPEG LA H.264 patent pool cannot itself dictate the RAND royalty rate, but it can serve as an indicator of a royalty rate that falls within a RAND range.<sup>184</sup>

The calculation started by estimating the amount Microsoft would pay if Motorola received royalties equivalent to what it would receive if Motorola's and other H.264 SEP holders' SEPs were all added to the pool at the current pool rate structure.<sup>185</sup> Under this scenario, Microsoft would pay 0.185 cents per unit.<sup>186</sup> Because the royalty rate Motorola would receive under the patent pool represents only a portion of the value Motorola would receive as a member of the patent pool (the value to Motorola of having full access to the other technologies within the patent pool), and because Microsoft (also a member of the MPEG LA H.264 patent pool) pays twice as much *for* licensing from the pool as it receives *from* licensing, the court concluded that Microsoft valued membership in the MPEG LA H.264 pool as twice the value of the royalty rates it received.<sup>187</sup> The court concluded that the valuation for Motorola's H.264 SEP portfolio is:<sup>188</sup>

$$0.185 \frac{\text{cents}}{\text{unit}} + \left( 2 \times .185 \frac{\text{cents}}{\text{unit}} \right) = .555 \frac{\text{cents}}{\text{unit}}$$

The court then calculated the upper bound of the RAND royalty rate for Microsoft's H.264 SEP portfolio. The primary *Microsoft* factor in calculating the upper bound is factor 15: "The anti-stacking principle constrains RAND because parties in a RAND negotiation would determine a reasonable royalty by considering how much in total license fees the implementer can pay

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181. *Id.* at \*219.

182. *Id.*

183. *Id.* at \*231–38.

184. *Id.* at \*239.

185. *Id.* at \*244.

186. *Id.* at \*245.

187. *Id.* at \*246–47.

188. *Id.* at \*259. This amount represents the low end of the range of a RAND royalty rate for Motorola's H.264 SEP portfolio. *Id.* at \*255.

before implementation of the standard becomes cost-prohibitive.”<sup>189</sup> The court found the highest fee discussed during formation of the MPEG LA H.264 patent pool—an uncapped 150 cents per unit price—to be best evidence of the high point of customary businesses licensing of the RAND-committed patents (*Microsoft* factor 12).<sup>190</sup> Based on the pro rata share of Motorola’s SEP portfolio, Motorola’s SEPs contribute a value of 5.463 cents to each unit, which is valued in total at 150 cents per unit.<sup>191</sup> As the court earlier determined that Motorola’s membership in the patent pool and access to the technology within is twice the amount of royalties received, the court determined that the upper bound of a RAND royalty for Motorola’s SEP portfolio is:<sup>192</sup>

$$5.463 \frac{\text{cents}}{\text{unit}} + \left( 2 \times 5.463 \frac{\text{cents}}{\text{unit}} \right) = 16.389 \frac{\text{cents}}{\text{unit}}$$

The court found that, based on Motorola’s technology represented in the H.264 Standard, there would be no reason to set the value at a higher amount.<sup>193</sup> This conclusion is due to *Microsoft* factors 6, 8, 9, 10, and 11.<sup>194</sup> The court examined closely the importance of each of Motorola’s H.264 SEPs and found that, “although some of the patents contributed to the H.264 Standard, others provided only minimal contribution due to the availability of alternative technology.”<sup>195</sup> Additionally, fourteen of Motorola’s sixteen patents covered interlaced video compression, a technology that the court determined was not overly important to Microsoft products utilizing the H.264 Standard.<sup>196</sup> And of the two remaining Motorola SEPs, Microsoft products only implemented one.<sup>197</sup> In other words, Motorola’s H.264 SEPs contributed minimally to the standard and the standard contributed minimally to Microsoft’s products.

#### 4. *Valuation of Motorola’s SEPs Relating to the 802.11 Standard*

The 802.11 Standard is a Wi-Fi standard. The standard allows companies to build products to a set of specifications for wireless local area

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189. *Id.* at \*260.

190. *Id.* at \*261.

191. *Id.* at \*262.

192. *Id.*

193. *Id.* at \*248.

194. *Id.* at \*54–65.

195. *Id.* at \*257.

196. *Id.*

197. *Id.* at \*257.

networking.<sup>198</sup> The court noted that the 802.11 Standard is the de facto standard for wireless home networks.<sup>199</sup> There are currently estimated to be thousands of patents essential to the 802.11 Standard.<sup>200</sup> The court noted that Motorola presented only “scant evidence that its patents are essential to the 802.11 Standard.”<sup>201</sup> Due the scarcity of evidence, the court diminished their value and evaluated the importance of Motorola’s 802.11 SEPs only in relation to the one Microsoft product that Motorola alleged used the pertinent patent—the Xbox.<sup>202</sup> Ultimately, the court determined the RAND royalty rate for Motorola’s 802.11 SEP portfolio at 3.471 cents per unit.<sup>203</sup> The court set the upper bound of a RAND royalty range at 19.5 cents per unit and the lower bound at 0.8 cents per unit.<sup>204</sup> The set rate and upper RAND rate is applicable to Microsoft’s Xbox sales. However, for all other Microsoft products, the lower bound of 0.8 cents per unit would be used.<sup>205</sup>

Pursuant to *Microsoft* factor 12, the court considered three possible indicators for the RAND rate and range for Motorola’s 802.11 SEPs.<sup>206</sup> The first was the Via 802.11 patent pool.<sup>207</sup> The court noted that, like in the RAND royalty rate and range determination for the H.264 Standard, membership in the patent pool would provide value to Motorola of twice the royalties it would receive from the pool, thus alleviating concern of under-compensating SEP holders for their technology and participation in patent pools.<sup>208</sup> The court’s pro rata determination of Motorola’s SEPs within the Via 802.11 patent pool was 2.038 cents per unit.<sup>209</sup> Increasing the value due to Motorola’s membership in the pool amounts equals:<sup>210</sup>

$$2.038 \frac{\text{cents}}{\text{unit}} + \left( 2 \times 2.038 \frac{\text{cents}}{\text{unit}} \right) = 6.114 \frac{\text{cents}}{\text{unit}}$$

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198. *Id.* at \*140.

199. *Id.*

200. *Id.* at \*274.

201. *Id.* at \*152.

202. *Id.* at \*152–53.

203. *Id.* at \*20.

204. *Id.*

205. *Id.*

206. *Id.* at \*294.

207. *Id.* at \*268 (stating that “the Via Licensing 802.11 patent pool is an indicator of a RAND royalty rate for Motorola’s 802.11 SEP portfolio, albeit not as strong an indicator as the MPEG LA H.264 patent pool”).

208. *Id.* at \*269. For discussion of the H.264 patent pool’s effect on valuation, see *supra* notes 177–90 and accompanying text.

209. *Id.* at \*274.

210. *Id.*

The second indicator was the Marvell Wi-Fi Chip. Microsoft currently pays just under \$3 per Marvell chip to provide 802.11 functionality to the Xbox.<sup>211</sup> The Marvell chip is the smallest salable unit that implements the standard.<sup>212</sup> Marvell pays a one percent royalty rate and licensing fee on the chip for software and design help in creating embedded microprocessors,<sup>213</sup> resulting in a calculation of:

$$.01 \times 3000 \frac{\text{cents}}{\text{unit}} = 3 \frac{\text{cents}}{\text{unit}}$$

The court held that although one percent is a high benchmark, under *Microsoft* factor 12, the Marvell chip is an indicator of a RAND rate for Motorola's 802.11 SEP portfolio, resulting in an estimate of three cents per chip.<sup>214</sup>

The third indicator was the InteCap Analysis.<sup>215</sup> InteCap specialized in valuing patent portfolios for the purpose of maximizing royalty income through the monetization of patents.<sup>216</sup> InteCap's analysis amounted to 0.1 percent of the end product price of implementing products, which would result in twenty cents to forty cents per Xbox, which are typically sold for \$200 to \$400 per unit.<sup>217</sup> However, the court did note that the InteCap Analysis overemphasized the importance of Motorola's 802.11 SEPs, and therefore parties in a negotiation would consider it less important than the Via 802.11 Licensing Pool and the Marvell Wi-Fi chip.<sup>218</sup> Accordingly, the RAND royalty rate using the InteCap Analysis was diminished by a factor of twenty-five, producing a royalty rate between 0.8 and 1.6 cents per unit.<sup>219</sup>

$$\frac{1}{25} \left( .001 \times 20000 \frac{\text{cents}}{\text{unit}} \right) = .8 \frac{\text{cents}}{\text{unit}}$$

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211. *Id.* at \*279.

212. *Id.* at \*278–79. The Federal Circuit held that, in a situation where small elements of a multicomponent product are accused of infringement, "it is generally required that royalties be based not on the entire product, but instead on the 'smallest salable patent-practicing unit.'" *See LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 67 (Fed. Cir. 2012).

213. *Microsoft*, 2013 U.S. Dist. LEXIS 60233, at \*279.

214. *Id.* at \*283.

215. *Id.* at \*288–92.

216. *Id.* at \*284.

217. *Id.* at \*287.

218. *Id.* at \*292.

219. *Id.* at \*293.



$$\frac{1}{25} \left( .001 \times 40000 \frac{\text{cents}}{\text{unit}} \right) \equiv 1.6 \frac{\text{cents}}{\text{unit}}$$

The upper range was calculated similar to the upper range for the H.264 Standard (keeping in mind *Microsoft* factor 15).<sup>220</sup> The court took the highest royalty range offered by Microsoft in trial, 6.5 cents per unit based on the Via Licensing Pool, and increased it to account for added value due to membership in the pool.<sup>221</sup> Accordingly, the upper range was calculated at:<sup>222</sup>

$$6.5 \frac{\text{cents}}{\text{unit}} + \left( 2 \times 6.5 \frac{\text{cents}}{\text{unit}} \right) = 19.5 \frac{\text{cents}}{\text{unit}}$$

The court then chose the lower bound as 0.08 cents per unit, based on the InteCap evaluation, since there was little evidence within the record to determine a lower bound.<sup>223</sup>

Ultimately, the court set the RAND royalty rate at the average of the three estimates produced by the indicators, with some adjustments.<sup>224</sup> The court used the low point of the InteCap evaluation, 0.8 cents per unit, because it was based on the end-price of products rather than the importance of the SEP to the standard and the importance of the standard and the SEP to the product.<sup>225</sup> The court also split the range the Marvell chip produced to a figure of 3.5 cents per unit.<sup>226</sup> The final estimate was from the Via Patent Pool, 6.114 cents per unit. The average of the three estimates was 3.471 cents per unit.<sup>227</sup>

$$\frac{1}{3} \left( 0.8 \frac{\text{cents}}{\text{unit}} + 3.5 \frac{\text{cents}}{\text{unit}} + 6.114 \frac{\text{cents}}{\text{unit}} \right) = 3.471 \frac{\text{cents}}{\text{unit}}$$

Judge Robart's method is a very thorough framework for calculating RAND royalty rates and range. It is the first of its kind and imports a familiar damages calculation framework while customizing it to the purposes and

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220. *Id.* at \*298–301.

221. *Id.*

222. *Id.*

223. *Id.* at \*301–02.

224. *Id.* at \*296–97.

225. *Id.* at \*296.

226. *Id.*

227. *Id.* at \*296–97.

policy concerns of the RAND commitment. As such, the *Microsoft* framework was heavily referenced in the second judicially created RAND rate.

C. MODIFYING THE MICROSOFT FRAMEWORK: JUDGE HOLDERMAN'S TAKE

On October 3, 2013, the Northern District of Illinois created the second judicially determined RAND rate in *In re Innovatio IP Ventures, LLC Patent Litigation* (“*Innovatio*”).<sup>228</sup> *Innovatio* IP Ventures brought multiple suits alleging infringement of its SEPs related to the 802.11 Wi-Fi Standard against various implementers, which were then coalesced into a multi-district litigation case.<sup>229</sup> In *Innovatio*, the parties agreed to apply Judge Robart’s framework, with a few modifications, to the circumstances of the case.<sup>230</sup>

First, Judge Holderman stated that for this particular case, the purpose of the RAND determination was not for a jury to use to decide if a breach of contract had occurred.<sup>231</sup> Instead, the RAND determination in *Innovatio* was used to set damages for infringement of SEPs, and therefore only a single RAND rate would be set, rather than a range.<sup>232</sup> Next, because the court in *Innovatio* had already determined the essentiality of the SEPs, it did not adjust the RAND rate based upon pre-litigation uncertainty concerning the essentiality of a given patent.<sup>233</sup> Finally, the court determined that the appropriate royalty base for the determination was the Wi-Fi chip, the smallest saleable unit that implemented the 802.11 Standard.<sup>234</sup> The court noted that determining the importance of *Innovatio*’s SEPs to the 802.11 Standard effectively determines the importance of the SEPs to the Wi-Fi chip, as the sole purpose of the chip is to provide Wi-Fi functionality.<sup>235</sup> In this regard, the court merged the two central considerations of Judge Robart’s methodology and only evaluated the importance of *Innovatio*’s SEPs to the 802.11 Standard.<sup>236</sup>

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228. *In re Innovatio IP Ventures, LLC Patent Litig.*, MDL 2303, 2013 U.S. Dist. LEXIS 144061 (N.D. Ill. Oct. 3, 2013).

229. *Id.* at \*38.

230. *Id.* at \*50–51.

231. *Id.* at \*56.

232. *Id.*

233. *Id.* at \*56–59. In *Microsoft*, the calculation was based on a hypothetical negotiation in which the essentiality of Motorola’s SEPs would not have yet been judicially determined, and therefore the RAND rate was adjusted to account for skepticism regarding essentiality. *Id.* at \*152.

234. *Id.* at \*60.

235. *Id.*

236. *Id.*

In looking for indicators for the RAND rate, Judge Holderman looked at ex ante alternatives to the patented technology pursuant to *Microsoft* factor 9.<sup>237</sup> The manufacturers argued that if two patented and equally effective alternatives charge the same royalty rate, the price would effectively be negotiated down to zero.<sup>238</sup> Innovatio argued, and Judge Holderman agreed, that no patent holder would accept a royalty that is effectively zero because innovators must be compensated for their investment.<sup>239</sup> Accordingly, the court considered alternative technology but recognized that alternatives considered by the standard would not drive down price as much as alternative technology in the public domain.<sup>240</sup> Ultimately the court found that none of the alternatives presented would have provided all of the flexibility and functionality that Innovatio's SEPs provided to the 802.11 Standard.<sup>241</sup>

Pursuant to *Microsoft* factors 1 and 2, the court examined other licenses offered by Innovatio but ultimately determined that none were sufficiently comparable.<sup>242</sup> The licenses offered suffered from many of the same problems that those in *Microsoft* suffered from.<sup>243</sup> Innovatio's proposed licenses were often part of a larger settlement negotiation between parties, were adopted under the duress of litigation, or were non-RAND licenses—all of which meant that the licenses were not negotiated with the understanding of the goals of the RAND commitment in mind.<sup>244</sup>

Without comparable licenses, alternative technologies, or a useful patent pool,<sup>245</sup> the court adopted a “top down” approach as the best approximation of the RAND rate the parties would have likely agreed upon before Innovatio's patents were adopted into the standard.<sup>246</sup> This approach started

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237. *Id.* at \*100.

238. *Id.* at \*101.

239. *Id.* at \*101–02.

240. *Id.* at \*106.

241. *Id.* at \*120.

242. *Id.* at \*139–60.

243. *Id.* at \* 196, \*199, \*204, \*212.

244. *Id.* at \*139–60.

245. The Via Patent Pool used in *Microsoft* was also rejected due to the fact that the pool only had five licensors, thirty-five patents, and eleven licensees. Additionally, the court noted that patent pools do not distinguish between the technical merit of the patents in the pool, which can cause patent holders with valuable patents to not participate in the pool. The court noted that ultimately Judge Robart, although using the pool, determined that it did not have much significance to the RAND rate. Since Innovatio's patent portfolio was held to be of moderate-to-high importance, the court deemed it inappropriate to use a patent pool. *Id.* at \*155–59.

246. *Id.* at \*163.

with the average price of a Wi-Fi chip.<sup>247</sup> Next, the profit made on the chip was calculated in order to determine the income available with which the chipmaker can pay IP royalties. Profits of the chip were determined by subtracting the cost of manufacturing from the sale price.<sup>248</sup> Then, the available profit was multiplied by a fraction calculated as the number of Innovatio's 802.11 SEPs (nineteen), divided by the total number of 802.11 SEPs.<sup>249</sup> The court stated that focusing on the profits of the chip manufacturer, rather than the profit margins of the accused products, ensures that the same RAND rate charged to the chip manufacturer is charged to the implementers.<sup>250</sup> Ensuring that the same RAND rate is charged to both the chip manufacturer and implementers in turn ensures that the RAND rate is both reasonable and nondiscriminatory and thereby alleviates concerns of undue leverage and royalty stacking.<sup>251</sup>

Using the "top down" method of calculation, the court found that the parties would have agreed to an average chip price of \$14.85.<sup>252</sup> The chipmaker's profit margin on the Wi-Fi chip was determined at 12.1 percent.<sup>253</sup> This leaves an average profit of 180 cents per chip.<sup>254</sup> The total number of SEPs in the 802.11 Standard was estimated to be three thousand, though not all of those SEPs have had their essentiality judicially confirmed.<sup>255</sup> Having determined the elements, the court then undertook the calculation. Taking the 180 cents of profit per chip, the court then multiplied that by eighty-four percent, the value attributable to the top ten percent of all 802.11 SEPs to get 151 cents per chip.<sup>256</sup> The court then multiplied this by 19/300—the ratio of the contribution of Innovatio's SEPs to the 802.11 Standard—resulting in a calculation of:<sup>257</sup>

$$151 \frac{\text{cents}}{\text{unit}} \times \frac{19}{300} = 9.56 \frac{\text{cents}}{\text{unit}}$$

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247. *Id.*

248. *Id.* at \*163.

249. *Id.* at \*164.

250. *Id.* at \*164–66.

251. *Id.*

252. *Id.* at \*176.

253. *Id.* at \*177.

254. *Id.* at \*182.

255. *Id.* at \*180.

256. *Id.* at \*183.

257. The number three hundred is used to determine the pro rata share of the value in the top ten percent of all 802.11 SEPs attributable to Innovatio's nineteen SEPs that were determined to be of moderate-to-high importance *Id.*

The result of 9.56 cents per Wi-Fi chip is well within the *Microsoft* range set by Judge Robart.<sup>258</sup>

#### D. CONCLUSION: THE RAND RATE AS A REMEDY

Although *Microsoft* and *Innovatio* are the only two judicially created RAND rates to date, they demonstrate that the determination of a RAND rate itself is an effective remedy to the RAND commitment. Although Microsoft had a source for damages to claim after Motorola sought injunctive relief in the German courts, Microsoft started its litigation asking for a RAND rate to be determined in light of unreasonable demands.<sup>259</sup> That *Microsoft* used the RAND rate as a tool for the jury to determine if a breach of the duty of good faith and fair dealing occurred and *Innovatio* used it as a damages calculation speaks to the usefulness of a judicially determined RAND rate.

There is no doubt that RAND determinations are lengthy, expensive, and cumbersome for courts. And it is not ideal for courts to be flooded with requests for RAND determinations, either sincerely or as a negotiation tactic by implementers.<sup>260</sup> However, the next Part, which discusses the use of contract law as an enforcement mechanism, provides guidelines for behavior to reduce such concerns.

### IV. WHY CAN'T WE BE FRANDS? NAVIGATING THE CURRENT STATE OF THE LAW

The use of contract law as an enforcement mechanism, along with its implied duty of good faith and fair dealing, does seem to make the use of “FRAND” more appropriate: fair (dealing), reasonable, and nondiscriminatory. From the perspectives of both an implementer and an SEP holder, this Part discusses how to navigate the current state of the law. This Part will conclude by discussing some of the interesting alternatives to contract law enforcement that may become available in the future.

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258. The court noted that, because the rate fell comfortably within the RAND range Judge Robart had determined for Motorola’s eleven SEPs, the *Innovatio* rate is clearly reasonable. *Id.* at \*185.

259. *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 U.S. Dist. LEXIS 146517, at \*14 (W.D. Wash. Oct. 10, 2012).

260. This is due to the incredible amount of resources courts must use to determine RAND rates. For the purposes of illustration, Judge Robart’s calculation spanned 208 pages. *See Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233 (W.D. Wash. Apr. 25, 2013). Judge Holderman’s calculation, which simplified Judge Robart’s method, was still eighty-nine pages. *See In re Innovatio IP Ventures, LLC Patent Litig.*, MDL 2303, 2013 U.S. Dist. LEXIS 144061 (N.D. Ill. Oct. 3, 2013).

A. AT WHAT POINT DOES AN IMPLEMENTER USE THE ENFORCEMENT MECHANISM PROVIDED BY CONTRACT LAW?

Determining when an implementer is able to use contract law as an enforcement mechanism depends on whether an implementer is responding to an unreasonable offer letter or an infringement suit requesting injunctive relief (or a Section 337 investigation in the ITC).

1. *If Receiving an Unreasonable Offer Letter*

An offer letter from an SEP holder arrives that seems unreasonable—now what?<sup>261</sup> First, an implementer must determine if the offer letter is, in fact, unreasonable. How is that determination made? If the offer letter uses a percentage of an end product price, it has waded into “unreasonable” territory. As previously discussed, both courts in *Microsoft* and *Innovatio* took a skeptical view of using a percentage of the end product price as a royalty rate.<sup>262</sup> If the offer letter is actually unreasonable, is it *so* unreasonable that it breaches the duty of good faith and fair dealing? If yes, then the implementer now has a breach of contract action.<sup>263</sup> However, the implementer must be willing to abide by the determined RAND rate.<sup>264</sup>

If the offer is not so unreasonable as to breach the duty of good faith and fair dealing, the implementer should negotiate. If the SEP holder is unresponsive to negotiation or unwilling to lower its unreasonable rate but has still not filed an infringement action, the implementer can consider filing an action for anticipatory breach of contract. However, the doctrine of anticipatory breach “requires a positive statement or action by the promisor indicating distinctly and unequivocally that he or she either will not or cannot substantially perform any of his contractual obligations.”<sup>265</sup> Because

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261. If the implementer receives a reasonable offer letter, it would either enter into a license, initiate negotiations to get an even better rate, or if doubting the validity of the patents, would bring an action for declaratory judgment challenging the validity of the patent. Any of these options are outside the scope of this Note.

262. *See supra* Part III.

263. If the implementer has not experienced damages thus far, it can plead for relief for nominal damages and a judicially determined RAND rate. *See Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061 (W.D. Wis. 2012).

264. *See Apple, Inc. v. Motorola Mobility, Inc.*, 11-CV-178-BBC, 2012 WL 7989412 (W.D. Wis. Nov. 8, 2012). Judge Crabb dismissed Apple’s suit after Apple refused to agree to be bound by the judicially determined RAND rate; Judge Crabb stated that it would be inappropriate for a court to conduct a RAND trial merely to produce a negotiation tool. *Id.*

265. *Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1036 (W.D. Wash. 2012). This standard is likely to make anticipatory breach difficult to prove unless negotiations have become so untenable that the implementer can prove that the SEP holder has effectively stated that it will not license on RAND terms by the course of its behavior.

anticipatory breach may be difficult to prove, the best course of action is to negotiate in good faith. If the SEP holder refuses to negotiate, a breach of contract action may be borne out of that refusal as the negotiation process is inherent to licensing on RAND terms and therefore likely a contractual obligation the SEP holder is required to perform.<sup>266</sup>

## 2. *If Responding to an Infringement Action*

If the implementer is responding to an infringement action, the main considerations are whether injunctive relief has been sought and where the infringement action has been brought. If the infringement action has been brought in district court, then the implementer can mount a RAND affirmative defense to either offset the possibility of injunctive relief or ask for a RAND determination for the damages calculation.<sup>267</sup> It is important to note that the RAND commitment must be raised as an affirmative defense in this context.<sup>268</sup> If an implementer waives the affirmative defense they will be precluded from raising the RAND commitment elsewhere during litigation.<sup>269</sup>

If the action is being brought in a foreign court or the ITC and injunctive relief has been either sought *or* granted, the duty of good faith and fair dealing has been breached, and the implementer can file a breach of contract suit in district court asking for the SEP holder to be enjoined from enforcing the injunction or exclusion order.<sup>270</sup> Alternatively, the implementer can raise a RAND affirmative defense if the foreign court recognizes third-party beneficiaries. The implementer may also be able to raise a RAND affirmative defense in the ITC, but as yet there is no case law from the ITC on RAND contractual issues that indicate how such an analysis would be undertaken. Either way, a contractual analysis of RAND is best done in U.S. district

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266. *See supra* Section II.B.

267. *See supra* Section II.E; *see also supra* Section III.C.

268. *See* *Wi-Lan, Inc. v. HTC Corp.*, No. 2:11-cv-00068-JRG, at \*8 (E.D. Tex. Oct. 11, 2013) (stating that FRAND must be used as an affirmative defense and not simply a response to damages calculations).

269. *Id.*

270. *See* *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872 (9th Cir. 2012) (affirming the district court's preliminary injunction to enjoin Motorola temporarily from enforcing a patent injunction that it obtained against Microsoft in Germany); *see also* *Realtek Semiconductor Corp. v. LSI Corp.*, at 1008 (N.D. Cal. Oct. 10, 2012) (filing for breach of contract in district court before the ITC had concluded the 337 Investigation or issued an exclusion order).

courts due to the precedent *eBay* set and the persuasive case law *Microsoft* and *ReakTek* have established.<sup>271</sup>

Implementer response to an infringement action is perhaps the easiest scenario under the current state of law relating to the RAND commitment. Seeking injunctive relief prior to negotiations for a RAND rate provides an immediately actionable harm and triggers a contractual analysis widely accepted in district courts.<sup>272</sup> It is a more ambiguous question as to how a breach of contract analysis would result should RAND negotiations occur and fail prior to seeking injunctive relief. This situation may trigger a “reasonableness” analysis of the proffered royalty rate offers to determine if the SEP holder breached its duty of good faith and fair dealing by seeking injunctive relief or if the implementer was an unwilling licensee by refusing a RAND rate, thereby making injunctive relief appropriate.

#### B. HOW AN SEP HOLDER CAN AVOID OR MAKE MOOT A BREACH OF CONTRACT ACTION

As the majority of this Note has detailed how implementers can use contract law as an enforcement mechanism to the RAND commitment, it may be useful to examine how an SEP holder can receive the reasonable royalty rates they are entitled to without risking a RAND offense. This can be done in two primary ways: through the thoughtful crafting of an offer letter and refraining from seeking injunctive relief before a RAND rate has been offered.

##### 1. *The Offer Letter: Avoiding a RAND Offense*

As *Microsoft* demonstrated, the offer letter can be an immediate source of trouble. True, the court in *Microsoft* held that there is a difference between a reasonable offer and a reasonable license (the latter being required but not the former).<sup>273</sup> However, the offer cannot be so unreasonable as to breach the

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271. *See generally* *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 U.S. Dist. LEXIS 146517, at \*25–30 (W.D. Wash. Oct. 10, 2012) (holding that the RAND commitment is an enforceable contractual obligation to which Microsoft is a third-party beneficiary); *Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998, 1010 (N.D. Cal. 2013) (holding that the defendants were contractually obligated to license on RAND terms to third-party beneficiary Realtek).

272. *See* *Apple, Inc. v. Motorola, Inc.*, 869 F. Supp. 2d 901, 2012 U.S. Dist. LEXIS 89960, 2012 WL 2376664, at \*12 (N.D. Ill. June 22, 2012) (stating that the court would not “be justified in enjoining Apple from infringing, unless Apple refuses to pay a royalty that meets the FRAND requirement”); *Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998, 1010 (N.D. Cal. 2013) (stating that seeking injunctive relief before undertaking RAND negotiations is a per se breach of contract).

273. *See supra* Section III.A.



duty of good faith and fair dealing.<sup>274</sup> How is that to be avoided? Primarily, the SEP holder should not use a percentage of the end-product price.<sup>275</sup> The court in *Microsoft* criticized Motorola's calculation of a reasonable royalty based on 2.25 percent of the end-product price of implementing products.<sup>276</sup>

However, it is not required that the SEP holder actually produce a RAND offer, just an offer made in good faith. What does that mean? Under *Microsoft*, this means commercial tenability.<sup>277</sup> The SEP holder can demonstrate that an offer falls within commercial viability by demonstrating that, in calculating the offered royalty rate, the issue of royalty stacking was considered and accounted for. As most multi-component products implement multiple standards that involve hundreds to thousands of SEPs, a percentage of the end-product price will almost never be appropriate. An option to address royalty stacking (*Microsoft* factor 15) is to turn to a percentage price per unit of the smallest salable part implementing the standard to which the SEPs relate. Alternatively, the SEP holder can establish that it had a good faith belief that the offer was commercially tenable by showing that its calculation took into consideration the value of its SEPs to the standard and the contribution of the standard and its SEPs to the products at issue. This showing aligns with *Microsoft* factors 6, 8, 10, 11, and 13.<sup>278</sup> The offered rate is not required to be actually commercially tenable, but believed in good faith to be commercially tenable, from which negotiations would commence.<sup>279</sup>

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274. *Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1038 (W.D. Wash. 2012).

275. *See Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233, at \*191–98 (W.D. Wash. Apr. 25, 2013).

276. *Id.*

277. *Microsoft*, 2013 U.S. Dist. LEXIS 60233, at \*213–14.

278. *Id.* at \*59–65.

279. Additionally and obviously, the parties must negotiate in good faith. Although the courts have not undertaken the question of procedural or substantive bad faith in negotiation or if there is an obligation to negotiate, the answer is not difficult to predict. Negotiation is discussed within the policies of the ITU in lieu of specifics of what constitutes a RAND rate. It is then logical to state that SEP holders have a contractual obligation to negotiate in good faith, as negotiation is inherent to the licensing. *See ITU Common Patent Policy*, *supra* note 23 (stating that negotiations are left to the parties); *see also Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1031 (W.D. Wash. 2012) (rejecting Motorola's conception of the RAND commitment as a unilateral offer, which would not entail negotiation).

## 2. *Refraining from Injunctive Relief*

Rulings in *Microsoft* and *Realtek* generally foretell the end of injunctive relief as a remedy for SEP infringement litigation.<sup>280</sup> Although this spells the end of a powerful negotiation and settlement tactic, it may not amount to that big of a loss. This is because, as previously discussed, seeking an injunctive relief can trigger a breach of the duty of good faith and fair dealing, thereby triggering either a breach of contract action or a RAND affirmative defense.<sup>281</sup> So removal of injunctive relief in the RAND context removes a cause of action or an affirmative defense for implementers.<sup>282</sup>

SEP holders still retain a great deal of negotiation power, as most implementers will not wish to go through the time and expense of litigating a full RAND case. Injunctive relief is a powerful motivator to litigate and has been a central cause of many of the recent decisions that more firmly constrain SEP holders' actions.<sup>283</sup> Additionally, the use of injunctive relief in the RAND context has spurred increased public and political scrutiny of SEP litigation, resulting in a rarely used Presidential veto of an ITC decision and the possibility of the federal government becoming involved in the licensing of SEPs.<sup>284</sup> Constraining the use of injunctive relief may be in the long-term interests of SEP holders.

It should be noted that even with current disapproval, injunctive relief has not been completely removed as a remedy. Timeliness of filing for injunctive relief is the primary factor of judicial disapproval. *Realtek* ruled that seeking injunctive relief *prior* to offering a RAND rate is a *per se* breach of contract.<sup>285</sup> But the court specifically limited its holding to these facts,<sup>286</sup> leaving open the possibility that injunctive relief may still be appropriate if an implementer has rejected a RAND rate.

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280. *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 885 (9th Cir. 2012) (intimating that injunctive relief is inconsistent with the RAND commitment); *Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998 (N.D. Cal. 2013).

281. *See supra* Sections II.E (discussing injunctive relief) and IV.A.2 (discussing responding to an infringement action).

282. *See supra* Section II.E (discussing injunctive relief).

283. *See, e.g., Microsoft*, 696 F.3d 872; *Realtek*, 946 F. Supp. 2d 998.

284. *See* Presidential Veto, *supra* note 74; *see also* The Innovation Act, H.R. 3309, 113th Cong. (2013) (giving the FTC authority to regulate unfair licensing demands). The bill has since passed the House and is up for debate in the Senate. Innovation Act, H.R. 3309, 113th Cong. (2013).

285. *Realtek*, 946 F. Supp. 2d at 1008.

286. *Id.* (“The court’s breach of contract holding is limited to the situation here, where defendants did not even attempt to offer a license . . .”).

### 3. *Ambiguous Territory: How to Moot a RAND Defense*

The rejection of a RAND rate raises the issue of an unwilling licensee. And finding an implementer to be an unwilling licensee may be the only way to eliminate a RAND affirmative defense. However, there is no judicially determined definition of what constitutes an unwilling licensee in the RAND context. Judge Robart's logic indicates that a licensee does not become willing when refusing an initial offer—after all, Microsoft's refusal of the initial offers was not a repudiation of its third-party beneficiary rights.<sup>287</sup> However, if the initial offer is in fact reasonable, then perhaps a refusal may constitute unwillingness. That then begs the question of how an implementer is to know that the offer is reasonable, much like the question of how an SEP holder is to know an offer is unreasonable. And perhaps the answer to both is the same: commercial tenability.<sup>288</sup>

It is unclear if an implementer refusing to negotiate by not responding to attempts to negotiate constitutes unwillingness. On the one hand, is non-responsiveness a positive statement or action?<sup>289</sup> If anything, non-responsiveness seems to be an absence of action. On the other hand, to *not* respond in a bilateral negotiation seems to quite clearly signal an unwillingness to substantially perform contractual duties. But third-party beneficiaries do not typically have contractual obligations. The court would be required to read into an implementer's membership in a SSO the duty to negotiate in good faith for RAND licenses. Surely the answer as to when an implementer becomes an unwilling licensee lies somewhere *after* the refusal of the first offer and *before* the refusal of judicially determined RAND rate. Until a court defines an "unwilling licensee," it is best practice to proceed as if an implementer is a willing licensee and offer and negotiate royalty rates in good faith.

#### C. ALTERNATIVES TO CONTRACT LITIGATION

Accompanying the growing concerns over the increase in SEP litigation are proposals to move parties from litigation back to negotiation or into arbitration. This section will briefly discuss two of these proposals as examples of non-litigious routes.

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287. *See* Microsoft Corp. v. Motorola, Inc., 864 F. Supp. 2d 1023, 1036 (W.D. Wash. 2012).

288. *See* Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2013 U.S. Dist. LEXIS 60233, at \*213–14 (W.D. Wash. Apr. 25, 2013). For discussion on determining unreasonable offers, see *supra* Section IV.B.1.

289. Note that non-responsiveness here is meant in the literal sense and not in the contract law concept of silence.

### 1. *Baseball-Style Arbitration*

Mark Lemley and Carl Shapiro propose an interesting arbitration format in a recent article.<sup>290</sup> Under their approach, if an SEP holder and an implementer cannot agree on licensing terms, the SEP holder is obligated to enter into binding, “baseball-style” arbitration with any implementer to determine the royalty rate.<sup>291</sup> During this arbitration, each party submits its final offer to the arbitrator, who then chooses one of the two offers.<sup>292</sup> This obligation to enter arbitration may be dependent upon the implementer making a reciprocal commitment for any SEPs it owns that relate to the same standard.<sup>293</sup> If the implementer is unwilling to enter into binding arbitration, the SEP holder is able to go to court to enforce its SEPs against the unwilling implementer.<sup>294</sup>

In order to accomplish this framework, SSOs would need to make binding arbitration a contractual obligation while contracting with patent holders during the standard-setting process.<sup>295</sup> It is unclear if SSOs would be willing to do so, or what the effect would be if only some SSOs chose to implement binding arbitration clauses. However, Professors Lemley and Shapiro argue that this style of arbitration serves the aims of the RAND commitment by eliminating issues of patent holdup and undue leverage, as well as resolving the issue of injunctive relief in the RAND context.<sup>296</sup>

### 2. *Borrowing a Proposed Copyright Licensing Model*

Another option for reducing SEP litigation is adoption of a proposed copyright licensing model. Peter Menell and Ben Depoorter proposed a novel mechanism for copyright licensing that could be imported into the RAND licensing context.<sup>297</sup> Importation of their model into the RAND context would work in the following way:<sup>298</sup>

The implementer would have the authority to make a formal offer of a royalty rate for the use of the SEP holder’s SEP portfolio. If the SEP holder did not respond, the implementer would continue to implement the standard

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290. Lemley & Shapiro, *A Simple Approach*, *supra* note 81.

291. *Id.* at 1135.

292. *Id.* at 1138.

293. *Id.* at 1135.

294. *Id.*

295. *Id.* at 1138.

296. *Id.*

297. See Peter S. Menell & Ben Depoorter, *Copyright Fee Shifting: A Proposal to Promote Fair Use and Fair Licensing*, 105 CALIF. L. REV. 53 (2014).

298. For the explanation of the mechanism in the copyright context, see *id.* at 71–75.

(and the corresponding SEPs) but would pay their offered royalty rate into escrow. If the SEP holder rejected the proposed royalty rate and sued for infringement, the SEP holder would bear the implementer's litigation costs if the court determined that implementer's offered royalty rate was a RAND rate. Where, in the copyright case, the escrow amount would be returned to the original party, in the RAND context it would still likely go to the SEP holder, as they would be entitled to reasonable royalty rates under the policy goals and contractual obligations of the RAND commitment.

This approach places implementers in a more proactive position, allowing them to initiate licensing negotiations. Furthermore, it incentivizes parties to come to the negotiation table sooner and could ease the financial burden on implementers when enforcing the RAND commitment. It may also relieve some of the onus placed on SEP holders to enforce their rights to reasonable royalty rates. However, this framework may raise similar contractual issues to those raised in response to Motorola's argument that implementers must apply for a RAND rate, which the court rejected as inconsistent with the RAND commitment.<sup>299</sup> This fee shifting mechanism would also have to be adopted by the SSOs, which is subject to the same concerns as the arbitration proposal.<sup>300</sup>

These two proposed alternatives to litigation are compelling and address some of the concerns about the use of contract law: the length and cost of litigation, the amount of resources RAND determinations could consume if district courts are increasingly asked to calculate them, and the fact that the RAND commitment was meant to reduce, not promulgate, litigation. Both proposals emphasize the importance of negotiation and incentivize a negotiation's successful completion.

However, both would require major policy changes by SSOs.<sup>301</sup> Even if only the SSOs that produce standards in the tech industry (where most of the SEP litigation arises from) chose to make the switch, there would need to be a consensus amongst SSOs in the wording of this extra contractual duty to ensure that two companies are not undergoing multiple procedures in a single transaction or dispute, just because the standards are from differing

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299. *Microsoft Corp. v. Motorola, Inc.*, 864 F. Supp. 2d 1023, 1034 (W.D. Wash. 2012).

300. For discussion of the arbitration model, see *supra* Section IV.C.1.

301. For a more in-depth discussion of SSO-required arbitration and benefits and drawbacks companies may experience, see Jorge L. Contreras & David L. Newman, *Developing a Framework for Arbitrating Standards-Essential Patent (SEP) Disputes*, J. OF DISPUTE RESOLUTION (forthcoming 2014).

SSOs. It is also unknown if SSOs would be willing to involve themselves with how negotiations are conducted and how disputes are resolved.<sup>302</sup>

#### D. CONCLUSION

There is likely no single solution to the problem of increased SEP litigation. SEP litigation is complex, with its causes numerous and swiftly changing. But *Microsoft* and resulting cases used contract law to formulate the RAND commitment as a contract, identify implementers as third-party beneficiaries, establish the duty of good faith and fair dealing as a standard of conduct, and determine injunctive relief as an inappropriate remedy and state the actual harm suffered in the RAND context—all of which provided the enforcement mechanism that the RAND commitment had been lacking. Additionally, the groundbreaking RAND rate and range determination in *Microsoft* finally provided a judicial answer as to what a RAND rate actually is and provided a methodology for calculating it. Furthermore, the ability of the court to calculate a RAND rate provided both a much-needed remedy to the problem of stalled RAND negotiations and a forum in which relief can be sought.<sup>303</sup> So while new developments alter the landscape of SEP litigation on a near daily basis, *Microsoft* and subsequent cases have slowly cleared a walking path to guide companies along.

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302. *See supra* note 140.

303. *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp. 2d 993, 1036 (W.D. Wash. Feb. 27, 2012) (stating that the courthouse may be the only place to resolve differences when a third-party beneficiary does not believe the SEP holder is meeting its RAND obligations).