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Intellectual Property: A Special Report

"Court Sheds Light on Key Patent Licensing Issue"

By John "Jay" Jurata Jr., *The National Law Journal*

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Here's a common assumption among clients: "My company has a patent on that technology, so I have the legal right to decide whom to license that patent to, and on what pricing terms to do so."

Although it is well accepted that a patent grant is the right to exclude others from practicing that technology, the ability to do so is more nuanced when it comes to a special category of patents that previously were pledged to an industry standard. In those unique circumstances, it is becoming increasingly clear that patent owners may find themselves in hot water should they try to exclude others from using that technology, or attempt to charge excessive prices for access to that technology.

Industry standards allow today's devices to operate seamlessly with each other. Standards usually result from a collaborative process involving industry participants. By agreeing in advance as to how products made by different companies will technologically work together, standards provide an incentive for companies to make products that incorporate those standards. Consumers benefit by products coming to market faster and the certainty that products purchased from one manufacturer will work with products sold by a different manufacturer. Indeed, anyone who uses Bluetooth, watches high-definition TV, or uses a single micro USB to charge multiple devices has benefited from those standards.

Standards pose risks, however. Most all standards incorporate patented technology. Companies owning patents covering a standard — called standard-essential patents, or SEPs — might refuse to license them after the standard is finalized and adopted, or do so only under exorbitant terms and conditions.

This situation is known as "patent holdup," because companies without access to standard-essential patents cannot lawfully make standards-compliant products. If standard-essential patent owners engage in holdup, they can manipulate and distort the downstream markets for products incorporating the standard. Ultimately, this may artificially increase prices and decrease consumer choice.

To prevent holdup, standards-setting organizations generally require participants to promise to license their standard-essential patents to others on "fair, reasonable and nondiscriminatory terms." Commonly referred to as FRAND (or RAND, for short), this promise waives the right to exclude other companies from using those standard-essential patents in return for the standard-essential patent owner's patents being included in the standard.

Despite the fact that standards have been around for decades, until recently there was little case authority or guidance from competition agencies as to the meaning of FRAND. There was a handful of decisions concerning the necessity of participants in the standards-setting process to disclose potential standard-essential patents. But no court case or agency decision addressed what pricing terms and conditions did, or did not, comply with FRAND.

BILLIONS OF DOLLARS

The "smartphone wars", and the billions of dollars of potential profits at stake, changed the financial calculus. Over the past five years, patent infringement lawsuits involving Apple, Google, Motorola, Samsung and others raged around the globe. Some of those lawsuits used standard-essential patents to seek injunctions to stop alleged infringers from practicing the patents, which is a potential remedy in infringement cases.

But because those injunctions, if granted, would preclude companies from making standards-compliant products unless they agreed to pay the amounts demanded to settle the lawsuits, allegations followed that those standard-essential patent owners were violating their promises to license standard-essential patents on FRAND terms. Competition authorities opened investigations in some of those disputes, leading to settlements with certain standard essential patent owners to refrain from seeking injunctions except in rare circumstances.

Yet the scope of what specific pricing terms and conduct violated FRAND remained unclear until recently. On July 30, the U.S. Court of Appeals for the Ninth Circuit issued *Microsoft v. Motorola.* That case concerned a breach-of-contract lawsuit filed by Microsoft Corp. after Motorola Inc. demanded 2.25 percent of the price of any product incorporating Motorola's standard-essential patents covering wireless local area network standards and video-compression standards. Microsoft claimed that Motorola's license offer — which amounted to more than $4 billion per year — breached Motorola's promise to license its standard-essential patents on FRAND terms. Shortly thereafter, Motorola initiated various patent infringement proceedings seeking injunctions to exclude Microsoft's standards-compliant products.

The district court conducted an initial bench trial on FRAND. It concluded the proper FRAND royalty rate was well below 2.25 percent per unit — resulting in a royalty amount of only $1.8 million per year, far less than Motorola's licensing offer. Microsoft's breach-of-contract claim was then tried to a jury, where Microsoft argued that Motorola's licensing offer and seeking of injunctions were breaches of the implied covenant of good faith and fair dealing. The jury awarded Microsoft more than $14 million in damages.

The Ninth Circuit upheld all aspects of the district court's decision and jury verdict. Before addressing certain procedural and jurisdictional issues, the opinion explained that standard-essential patents are different than other patents due to the risk of holdup following a standard's adoption. The decision then proceeded to the issue of calculating FRAND royalties.

The Ninth Circuit concluded that the traditional method for determining reasonable royalties in patent cases — reconstructing a hypothetical negotiation between the parties using up to 15 different factors, commonly referred to as a Georgia-Pacific analysis — should be modified so as not to overvalue SEPs. It also held that Motorola's existing license agreements with other companies were not a reliable benchmark for determining a FRAND royalty because those earlier licenses involved a broader set of patents and were entered under threat of litigation.

Turning to the jury verdict, the decision concluded the jury had sufficient evidence to find that Motorola breached its duty of good faith and fair dealing with respect to its FRAND obligations. It noted that a jury could have inferred that Motorola sought an injunction against Microsoft's products to pressure Microsoft to accept a royalty rate that exceeded FRAND. The court also concluded that the damages resulting from Motorola's breach appropriately included the costs of defending against the injunction proceedings, among other items.

IMPORTANT TAKEAWAYS

Although certain aspects of the decision are unique to the underlying factual circumstances, there are several key takeaways that standard-essential patent owners and potential licensees should be mindful of:

• First, the decision provides an endorsed framework for determining FRAND royalties. The specific modifications the district court made to the traditional method of calculating reasonable royalties in patent cases, so as to ensure that standard-essential patents are valued separate and apart from the standard as a whole, is likely to become the primary benchmark in FRAND licensing disputes.

• Second, the decision issues a warning regarding seeking injunctions for standard-essential patents. The court found the mere fact that Motorola sought injunctive relief after Microsoft filed suit seeking a judicial determination of a FRAND royalty was sufficient proof for breach of contract. Thus, standard--essential patent owners run the risk of liability should they continue to seek injunctions against companies that have agreed to a binding determination of a FRAND royalty.

• Finally, the decision adds to the growing list of authority holding that the First Amendment right to petition courts for relief does not insulate standard-essential patent owners from liability for breaching a FRAND commitment. The court reasoned that Motorola's FRAND promise amounted to a voluntary waiver of the right to seek injunctive relief in certain circumstances. That conclusion reflects the practical reality that if standard-essential patent owners were allowed to use the doctrine as a shield when seeking injunctions against willing licensees, the FRAND commitment process relied upon by standard-setting organizations would become meaningless.

What an ultimate FRAND royalty equates to in a particular dispute depends upon the facts of the case, including the comparability of prior licenses and the relative technological importance of the relevant patents to the functionality of the underlying standard. But the Microsoft v. Motorola decision provides an important framework and guidance as to the limits on patent rights once a patent is voluntarily pledged by its owner to an industry standard.

About the Author

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