Ninth Circuit Upholds Judge Robart’s RAND Determinations in Microsoft v. Motorola

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Late last month, the Ninth Circuit Court of Appeals issued its much-anticipated decision in Microsoft v. Motorola, a breach of contract action brought by Microsoft alleging that Motorola violated its commitment to license its standard essential patents (SEPs) on reasonable and non-discriminatory (RAND) terms. In a detailed, 64-page opinion, the appeals court affirmed Judge Robart’s determination of the RAND rates for each of the two sets of SEPs at issue in the case, and upheld both the jury’s finding that Motorola breached its duty of good faith and fair dealing, and its $14.5 million damages award for that breach. Although not binding on the Federal Circuit, the Ninth Circuit’s decision touches on some of the important questions in the evolving jurisprudence of SEP enforcement.

Background

In October 2010, Microsoft sued Motorola before the International Trade Commission (ITC) and in a parallel action in the Western District of Washington for infringement of patents relating to smartphone technology. Later that month, Motorola sent Microsoft two letters offering to license each of two sets of standard essential patents—one relating to the 802.11 WiFi standard and the other to the H.264 video compression standard—for 2.25% of the selling price of each consumer product incorporating those standards. Both standards are incorporated in Microsoft’s Xbox video game console; the H.264 standard is also incorporated into Microsoft’s Windows operating system. That the patents were standard essential was not in dispute.

The following month, Microsoft brought a diversity action against Motorola in the Western District of Washington alleging that by sending the two offer letters, Motorola had violated its commitment to license its patents on RAND terms. Although Motorola’s commitment was to the standard-setting organizations (SSOs) promulgating the standards—here, the Institute of Electrical and Electronics Engineers (IEEE) and the International Telecommunications Union (ITU)—Microsoft brought the breach of contract claim as a third-party beneficiary of that commitment.

The next day, Motorola brought an action in the Western District of Wisconsin seeking to enjoin Microsoft from using its H.264 patents. That case was transferred to the Western District of Washington, and consolidated with Microsoft’s breach of contract action, both pending before Judge Robart. Motorola also filed a patent infringement action with the ITC seeking to enjoin Microsoft from importing the Xbox into the United States, and filed suit in Germany seeking to enjoin Microsoft’s sales of H.264-compliant products. As the Ninth Circuit observed, “[t]he German action was particularly threatening to Microsoft, as its European distribution center for all Windows and Xbox products was in Germany.” In response, Microsoft relocated its distribution center to the Netherlands to protect itself against the possible economic loss it would suffer if the German court were to issue an injunction. It also sought (and obtained) an order from the district court enjoining Motorola from enforcing any injunction issued by the German court. The Ninth Circuit affirmed Microsoft’s “anti-suit injunction” in September 2012.

Judge Robart stayed the patent infringement claims in the consolidated cases pending the outcome of the RAND issues, and then made the following legal determinations before holding a bench trial to determine a RAND rate for each set of SEPs: first, RAND commitments are enforceable contracts between the patent holder and the SSO; second, implementers of standards can enforce RAND commitments as third-party beneficiaries; third, while Motorola’s commitments to the SSOs require that its initial licensing offers be made in good faith, the offers themselves need not be on RAND terms, so long as a RAND license eventually issues; and fourth, Motorola was not entitled to injunctive relief on its H.264 and 802.11 patents.

After holding a bench trial, Judge Robart determined that the RAND rate for Motorola’s H.264 patent portfolio was .555 cents per end-product unit (with an upper bound of about 16 cents a unit), and that the RAND rate for its 802.11 patents was 3.71 cents per end-product unit (with a range of .8 cents to 19.5 cents per unit). Both rates were much lower than the approximately $4 per unit Motorola had sought in its offer letters. The case then proceeded to a jury trial on the breach of contract claim. The jury returned a verdict in favor of Microsoft finding that Motorola had breached its duty of good faith and fair dealing, and awarded Microsoft damages in the amount of $14.52 million, all but $3 million of which was for the cost of relocating its distribution center from Germany to the Netherlands. The rest of the damages award was for attorneys’ fees and litigation costs in defending against Motorola’s actions for injunctive relief. Motorola moved for judgment as a matter of law both as to the verdict and the damages award. The court denied Motorola’s motion on both grounds, and Motorola appealed the court’s denial to the Federal Circuit, which transferred the appeal to the Ninth Circuit on Microsoft’s motion.

The Legal Issues Before the Court

Jurisdiction

The Ninth Circuit’s first order of business was to address Motorola’s challenge to the court’s jurisdiction to hear the case in the first instance. The court determined that its prior exercise of jurisdiction on Motorola’s interlocutory appeal of the order enjoining Motorola from enforcing any injunction issued by the German court, coupled with the Federal Circuit’s transfer of the present appeal on jurisdictional grounds, “are both law of the case.” And, it further determined that because none of the exceptions to the
law-of-the-case doctrine applied—the earlier decisions were not clearly erroneous, for example, and there has been no intervening change in the law, and no other changed circumstances—it had jurisdiction to hear the case.

In so holding, the court rejected Motorola’s argument that because the RAND issues transformed the case “into a matter necessarily requiring the resolution of a substantial question of federal patent law,” the Federal Circuit’s decision to transfer the case was “clearly erroneous.” Although noting that the calculation of appropriate royalty payments in contractual license disputes “involves similar determinations to those that arise when calculating damages in patent infringement cases,” the court determined that this case was different: here, the mode of calculating damages for the breach of contract claim did not involve “any pure patent issue.” The fact that the threshold legal determination for the calculation of the breach-of-contract damages—the determination of the RAND rate—involves patent law does not transform the complaint into one “arising under” the patent law, the court said. Thus it concluded that “[t]his case … is a straight breach of contract action” over which it has jurisdiction.

The RAND Rate

The appellate court then turned to Motorola’s merits challenges to the district court’s judgment. After making short shrift of Motorola’s contention that it did not consent to the bench trial to determine the RAND rate, the court addressed Motorola’s substantive challenges to Judge Robart’s determination of the RAND rate, and rejected each in turn.

The Date of the Hypothetical Negotiation

First, the court rejected Motorola’s contention that the district court’s reasonable royalty analysis failed to take proper account of Georgia Pacific’s factor fifteen, which requires that the hypothetical negotiation be set “at the time the infringement began.” Although the appeals court acknowledged that the district court’s analysis had a “partial present-day focus,” this did not invalidate the district court’s RAND-rate determination, it said. The Federal Circuit has never held that all fifteen Georgia Pacific factors are relevant, the appeals court observed, and went on to note that the Federal Circuit cited Judge Robart’s analysis approvingly in its recent decision in Ericsson v. D-Link for the proposition that some of the Georgia Pacific factors may be “contrary to RAND principles.” Factor fifteen, the Ninth Circuit said, is a factor “that merits modification in some RAND contexts,” such as here, where “Motorola maintained its demand of a 2.25% royalty rate throughout the proceedings, and also pressed its injunction suits even after Motorola was on notice that its actions were in tension with its RAND obligations.”

Moreover, Motorola never specified the past date the district court should have used, the Ninth Circuit noted, and, in any event, both parties presented data spanning several years regarding the alleged value of Motorola’s patents to Microsoft, making it “impracticable for the court to consider only such evidence as could pinpoint the value of Motorola’s patents to Microsoft at a precise point in time.” And even if the district court erred, Motorola has never argued, let alone shown, “that it was prejudiced by the court’s analysis,” the appeals court noted. Without such a showing, it said, there is no basis to disturb the district court’s legal determination.

The Relevance of Patent Pools

Second, the court rejected Motorola’s challenges to the district court’s factual conclusions that (a) the rates charged by two patent pools are relevant and reliable indicators of the RAND rate for Motorola’s SEPs, and (b) Motorola’s historical licenses are not.

As the court explained, “[p]atent pools are collections of two or more SEP owners that package and license their SEPs collectively.” Contributors to the pool are given royalties on a per-patent basis, and “[t]ypically, pool members contributing their patents to the pool also become licensees of the pool’s patent package.” Recognizing that companies that contribute to patent pools derive value from their membership in the patent pool beyond the royalties they receive—mainly from the licenses to the pool’s patent package and from promotion of the standard—the district court multiplied the pool rates by three. Motorola argued that even so multiplied, the rates set by patent pools are too different from royalty rates that are the result of bilateral negotiations to serve as a reliable basis for determining RAND rates.

The court rejected Motorola’s argument that the pool rates were unreliable RAND-rate indicators. The court explained that for the 802.11 patents, the pool rate was just one of several relevant data points (and the most favorable to Motorola) on which the court relied. For the H.264 patents, the district court’s conclusion that the pool rate was a reliable indicator of the RAND-rate was reasonable, the appeals court said, because the patents at issue “were essential to the same technical standards, and Motorola provided no evidence that its patents were more valuable than the other patents in the pool.” Indeed, the court observed that the evidence suggested Motorola’s patents were, on average, less valuable than the other H.264 patents in the pool, so Motorola was “not prejudiced by the court’s assumption that its patents were of roughly equal value to those in the pool, as they probably were worth less.”

The Relevance of Motorola’s Other Licenses

The court also rejected Motorola’s argument that Judge Robart erred in not considering several agreements that included licenses to Motorola’s H.264 and 802.11 patent portfolios—and that were closer or equal to the 2.25% Motorola offered Microsoft—as probative of the RAND rate. After reviewing the license agreements at issue, the court observed that Judge Robart reasonably concluded that because these agreements were negotiated as part of larger settlements of infringement suits, or included cross-license terms and/or additional patents, they were not sufficiently comparable to the hypothetical license at issue to provide reliable indicators of the RAND rate for the patent portfolios in suit.

Breach of Contract

The appeals court then turned to the district court’s denial of Motorola’s motion for judgment as a matter of law (JMOL) that the jury’s finding that Motorola breached its duty of good faith was not supported by substantial evidence, and that the damages award was legally untenable, and rejected each of Motorola’s arguments in turn.
With respect to Motorola’s breach of contract agreement, the court noted at the outset that “the only damages argued for and awarded were tied to the fees for defending the injunctive actions and the costs of moving Microsoft’s European distribution facility out of Germany.” Therefore, the jury was instructed that to award damages, it had to find that those injunctive actions—without more—violated Motorola’s duty of good faith and fair dealing. However, in reviewing the district court’s order, the appeals court also evaluated the evidence pertaining to the impact of Motorola’s overall course of conduct—including its October 2010 offer letters—on the injunctive actions because the jury was also instructed that seeking injunctive relief was not a per se violation of the RAND commitment. Based on its review of that evidence including “the evidence that the rates Motorola sought were significantly higher than the RAND rate found by the court,” the appeals court concluded that there was enough evidence to suggest “that Motorola sought to capture more than the value of its patents by inducing holdup”—that is, using the threat of an injunction to extract a higher-than-RAND royalty for the practice of the patents once the standards into which they have been incorporated have been widely adopted—and that Motorola filed its injunctive actions to further its hold-up strategy.

The court went on to observe that the evidence of Motorola’s purported hold-up strategy was buttressed by the timing of its injunctive actions. Motorola filed its injunctive actions (a) immediately after the expiration of the twenty-day acceptance window provided in its offer letters, suggesting, the court said, that its offers were not meant to be taken seriously, and (b) after Microsoft filed its breach of contract action, at which point Motorola knew that the RAND rate would be adjudicated and that it would be fully compensated for any harm caused by Microsoft’s infringement. As such, it knew it would not suffer irreparable harm, and therefore that it could not prove its entitlement to injunctive relief. Based on the timing of Motorola’s injunctive actions, the court observed, “the jury could have inferred that the real motivation was to induce Microsoft to agree to a license at a higher-than-RAND rate.” Such an inference was all the more plausible in light of the evidence presented to the jury that Motorola was aware that the Federal Trade Commission (FTC) had investigated Motorola’s conduct regarding its RAND obligations and had found that conduct questionable.

**Damages**

Motorola made two arguments in support of its contention that the damages award was legally untenable; the Ninth Circuit rejected each in turn.

First, Motorola argued that the Noerr-Pennington doctrine, which generally shields individuals from liability for engaging in litigation, precluded any award for Motorola’s injunctive actions. “The doctrine does not, however, immunize a party from actions that amount to a breach of contract,” the court observed.

Second, Motorola argued that Washington law, which generally follows the American rule, precludes recovery of attorney’s fees except in certain narrowly defined circumstances, none of which apply here. This argument was similarly unavailing. The American rule concerns the propriety of awarding attorneys’ fees incurred by the prevailing party in a given case. As the court noted, “[t]he fees at issue here were incurred not in the current breach of contract action but in defending against the injunctive action found to have breached the RAND agreement. The fees sought are thus distinct from the same-suit fees generally banned by the American rule.” The court went on to observe that the losses Microsoft incurred in defending against the injunctive actions “are best characterized as recoverable consequential contract damages—the kind of damages ordinarily recoverable in breach of contract suits,” and then likened such consequential damages to “the common law rule that the victim of malicious prosecution can recover the reasonable costs he incurred in defending himself against the false accusations.”

The court then explained that, as a matter of public policy, recovery of attorneys’ fees as damages for the breach of a RAND commitment “makes particular sense in light of the purpose of the RAND commitment, which is to encourage widespread adoption of the standard.” That purpose, which promotes the public interest, would be substantially undermined if potential implementers of the standard were made to absorb the costs of defending themselves against actions for injunctive relief that were brought in bad faith.

**Evolving SEP Jurisprudence**

It remains to be seen whether Motorola will petition for full court or Supreme Court review of the Ninth Circuit’s panel decision. Still, because the decision addresses the proper methodology for determining RAND rates, the kind of competent and relevant evidence necessary to determine whether particular RAND commitments have been breached, and the proper measure of damages for such breaches, it is an important part of the evolving jurisprudence of SEP enforcement.

At the same time, however, its contribution to the public conversation regarding the scope and contours of SEP enforcement is somewhat limited. To the extent the decision discusses any of the underlying policy concerns animating that conversation, it focuses exclusively on the concerns over patent hold-up; it does not address any of the concerns regarding reverse patent hold-up—the attempt by implementers of standards to withhold fair compensation for the use of the patented inventions incorporated in those standards because they know that the worst that can happen to them is that they will ultimately have to pay the RAND rate if they are found to infringe—voiced in recent months. This is problematic. A singular focus on patent hold-up, to the exclusion of any concern that patent owners be fairly compensated for contributing their innovative technology to standard-setting bodies—makes it more likely that innovators will simply decide to opt out of standard-setting activities altogether. There is no upside to such an outcome; it will only serve to harm both the consuming public and the future of the American innovation economy.