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Defining "Reasonable" in RAND: A Bit of Common Sense

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I. INTRODUCTION

What is RAND? It's a simple question. Given the ubiquity of the term, one would think that the answer would be clear. After all, standard-setting organizations ("SSOs") around the world require patent holders to declare their standard-essential patents and commit to license on RAND terms. Competition law enforcement agencies have mandated RAND licensing in remedial orders. Courts have been asked to determine whether licensing offers are consistent with RAND. Yet after more than a decade of wrangling in legal disputes, antitrust enforcement investigations, and policy debates across the globe, the definition of RAND is still, to a large degree, an open and multifaceted question.[2]

One of the most hotly debated aspects of the question is: What is a "reasonable" royalty for a RAND-encumbered patent? The answer to this question is vital. Millions, perhaps billions, of royalty dollars ride on the answer. Moreover, whether a particular patent holder's licensing offers and licenses are "reasonable," and thus consistent with a RAND commitment, has implications for the ability to obtain injunctive relief, potential liability for breach of contract, and whether the patent holder's conduct violates competition law.

The debate over this issue is fierce.[3] It has recently focused on what standard-setting participants intended RAND to mean. The positions are starkly different, and weighing the divergent views is a complex and difficult task. Applying a little common sense, however, goes a long way to understanding this issue.

II. THE DEBATE: REASONABLE ROYALTIES AND THE PURPOSES OF RAND

What is a reasonable royalty turns, in part, on the purposes underlying the RAND commitment. Some say that the purposes of requiring RAND licensing are solely to (1) provide patent holders with sufficient compensation to ensure adequate incentives to invest in innovation and to contribute their patented technology to standards and (2) ensure that licenses are available to implementers of the standard. Noting that SSOs have not defined RAND in their intellectual property rights ("IPR") policies, advocates of this position insist that RAND terms were not intended to address supposedly "theoretical" concerns about patent holdup and royalty stacking. To use their term, RAND-encumbered patents are not "unique." These interests contend that standard-setting participants intended that reasonable royalties for RAND-encumbered patents

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[2] *See, e.g.*, European Competitiveness and Sustainable Industrial Policy Consortium, *Patents and Standards: A modern framework for IPR-based standardization*, at 184-88 (2014).

[3] Proponents on both sides of the aisle have vociferously promoted their views, flooding courts with amicus briefs, lobbying enforcement agencies, and stacking bar associations that may comment on the issues.

be determined by standard, off-the-shelf, patent-law methodologies, such as the *Georgia-Pacific* factors[4] used by U.S. courts in patent infringement damages cases.[5]

Certain U.S. courts, however, have held that off-the-shelf methodologies are inappropriate. These courts have significantly modified the *Georgia-Pacific* factors based on findings that the purposes behind requiring RAND licensing are to "mitigate the risk of patent hold-up"[6] and "address the risk of royalty stacking,"[7] in addition to ensuring that "holders of valuable intellectual property will receive reasonable royalties on that property,"[8] such that participants "have an appropriate incentive to invest in future development and to contribute their inventions to the standard-setting process."[9]

III. A FEW COMMON SENSE OBSERVATIONS

A. Vague IPR Policies: We've Been There Before

Part of the problem in defining RAND is that "there is a staggering lack of defining details" in the IPR policies.[10] "Without a clear policy, members form vaguely defined expectations as to what they believe the policy requires—whether the policy so requires or not."[11] Proponents of off-the-shelf patent methodologies point to this lack of detail as proof that holdup and royalty stacking concerns should not affect the royalty analysis. According to these proponents, the off-the-shelf royalty damages methodology fills the gap; "reasonable," they say, is a term of art that means *Georgia-Pacific*.[12]

The courts, however, have already dealt with the issue of whether patent holdup concerns underlie vague IPR policies in the context of disclosure rules. In fact, a district court reviewing the very policy that the Federal Circuit Court of Appeals deemed to have a staggering lack of detail held that a duty to disclose could nonetheless be based on a "clearly defined expectation" of standard-setting participants. The court held that a duty could be found based on (1) the expectations of individual members, (2) the behavior of members, (3) oral information shared at standard-setting meetings, (4) customs of the industry, and (5) the purpose of the SSO.[13]

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[4] *See Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), *mod. and aff'd*, 446 F.2d 295 (2d Cir. 1971).

[5] *See, e.g.*, Br. of *Amicus Curiae* American Intellectual Property Law Association in Support of Neither Party, *Microsoft Corp. v. Motorola, Inc.*, No. 14-35393 (9th Cir. filed Sept. 22, 2014).

[6] *Microsoft v. Motorola*, 2013 WL 2111217, at *12 (W.D. Wash. Apr. 25, 2013) (involving ITU, ISO/IEC, and IEEE policies) *see also In re* Innovatio IP Ventures, 2013 WL 5593609, at *9 (N.D. Ill. Oct. 3, 2013) (IEEE policy; "one of the primary purposes of the RAND commitment is to avoid patent hold-up").

[7] *Microsoft*, 2013 WL 2111217, at *12; *Innovatio*, 2013 WL 5593609, at *9.

[8] *Microsoft*, 2013 WL 2111217, at *12.

[9] *Innovatio*, 2013 WL 5593609, at *9.

[10] *Rambus Inc. v. Infineon Technologies AG*, 318 F.3d 1081, 1102 (Fed. Cir. 2003). *Rambus* involved disclosure duties, but the same comment applies to RAND.

[11] *Id.*

[12] Proponents of this view do not explain why participants in ex-U.S. standard-setting organizations, such as the ITU, would assume that "reasonable" refers to U.S. patent law on damages.

[13] *Hynix Semiconductor Inc. v. Rambus Inc.*, 2008 WL 2951341, at *2 (N.D. Cal. July 24, 2008).

Similarly, in another case involving "the consequence of silence in the face of a duty to disclose patents in a standard-setting organization,"[14] the Federal Circuit found such a duty despite a district court finding that the relevant IPR policies provided "no express requirement to disclose patents unless a member submits a technical proposal."[15] The Federal Circuit, however, went beyond the specific language of the IPR policies, noting, "to avoid 'patent hold-up' many SSOs require participants to disclose and/or give up IPR covering a standard."[16] The court emphasized that even if the written IPR policies did not clearly impose duty to disclose, the language of the IPR policies, coupled with evidence of participant understanding of the IPR policies, demonstrated a duty to disclose.[17]

With regard to the purpose of RAND commitments, the courts also have not been deterred by the lack of definition in the written IPR policies. The Third Circuit Court of Appeals, for instance, concluded that holdup concerns plainly animate RAND-commitment requirements: "To guard against anticompetitive patent hold-up, most SDOs require firms supplying essential technologies for inclusion in a prospective standard to commit to licensing their technologies on FRAND terms."[18] More recently, the Federal Circuit unequivocally associated RAND licensing requirements with holdup and stacking concerns:

> SEPs [(standard-essential patents)] pose two potential problems that could inhibit widespread adoption of the standard: patent hold-up and royalty stacking. Patent hold-up exists when the holder of a SEP demands excessive royalties after companies are locked into using a standard. Royalty stacking can arise when a standard implicates numerous patents, perhaps hundreds, if not thousands. If companies are forced to pay royalties to all SEP holders, the royalties will "stack" on top of each other and may become excessive in the aggregate. To help alleviate these potential concerns, SDOs often seek assurances from patent owners before publishing the standard. IEEE, for example, asks SEP owners to pledge that they will grant licenses to an unrestricted number of applicants on "reasonable, and nondiscriminatory" ("RAND") terms.[19]

Given this history, the lack of defining detail in standard-setting organization IPR policies cannot support the use of off-the-shelf methodologies that do not account for patent holdup and royalty stacking concerns.

B. Common Sense and Defining "Reasonable" in RAND

Insisting that RAND commitments are intended solely to ensure adequate compensation to patent holders and licenses available to all, proponents of the off-the-shelf *Georgia-Pacific* methodology claim that holdup and stacking concerns are inconsistent with these purposes. Despite the repeated findings of the courts, these proponents contend that there is no evidence standard-setting participants intended RAND commitments to address these concerns. The implication of this position is that standard-setting participants—patent holders, implementers,

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[14] *Qualcomm Inc. v. Broadcom Corp.*, 548 F.3d 1004, 1008 (Fed. Cir. 2008).

[15] *Qualcomm Inc. v. Broadcom Corp.*, No. 05-CV-1958, U.S. Dist. LEXIS 28211, at *34 (S.D. Cal. Mar. 21, 2007).

[16] 548 F.3d at 1011.

[17] *Id.* at 1015-16.

[18] *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 313 (3d Cir. 2007).

[19] *Ericsson, Inc. v. D-Link Sys., Inc.*, 773 F.3d 1201, 1209 (Fed. Cir. 2014).

and users—agree that "reasonable" in RAND is intended entirely to protect the interests of patent holders, ignoring the interests of others.

This view results in "reasonable" being a one-way street. It assumes that standard-setting participants expect a RAND commitment to place no upper constraint on the royalties they would be charged by patent holders different from the constraints of a royalty damages analysis under *Georgia-Pacific*. Besides making the "reasonable" in RAND superfluous, the one-way nature of this result runs counter to common sense.

1. Rational Licensees Avoid Buying a Pig in a Poke

Common sense says that licensees wouldn't agree to a methodology that allows for patent holdup. RAND commitments are given during the development, or at the time of adoption, of the relevant standard, i.e., generally before implementers have made standard-specific investments. But implementers do not commonly seek licenses from holders of patents that make RAND commitments at that time. Instead, as is well understood, standard-setting participants essentially agree to negotiate at a later time subject to the RAND commitment.

If the requirement of RAND licensing does not address patent holdup concerns, implementers have bought a pig in a poke. The *Georgia-Pacific* methodology posits a hypothetical negotiation at the time infringement began (rather than at the time the technology is adopted into the standard or the time of the RAND commitment).[20] If implementers have agreed to this methodology, they have set themselves up to be exploited.[21] If this is true, standard-setting participants have essentially opted "for RAND in order to randomly and artificially increase each patent holder's ultimate leverage."[22] Common sense tells us that licensors are not so irrational.

2. Real-World Negotiators Don't Assume Validity and Infringement

Common sense also says that participants would not agree to assume validity and infringement when negotiating a license pursuant to a RAND commitment. *Georgia-Pacific* posits a hypothetical negotiation between a willing licensee and a willing licensor who both assume the patent to be valid and infringed.[23] This assumption makes sense in the context of a damages analysis, which occurs after a finding of validity and infringement.

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[20] *See, e.g.*, *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1312 (Fed. Cir. 2011).

[21] The "basic economics of patent holdup in the standard-setting context are well understood." AM. BAR ASS'N, HANDBOOK ON ANTITRUST ASPECT OF STANDARD SETTING 100 (2d ed. 2011). After implementers have taken steps to produce standard-compliant products, patent holders are able to take advantage of specific investments and switching costs to demand royalties higher than could have been obtained before the adoption of the particular technology and the implementation of the standard. *See, e.g.*, Carl Shapiro, *Injunctions, Hold-Up, and Patent Royalties*, 12 AM. L. & ECON. REV. 280, 286-301 (2010). Holdup is not limited, as some would have it, to situations in which implementers are *denied access* to necessary patents.

[22] Doug Lichtman, *Understanding the RAND Commitment*, 47 HOUS. L. REV. 1023, 1033 (2010); *see also* Thomas F. Cotter, *Comparative Law and Economics of Standard-Essential Patents and FRAND Royalties*, 22 TEX. INTELL. PROP. L.J. 311, 358 (2014) ("Using the date of infringement in this context therefore is likely to exacerbate the risk of patent holdup.").

[23] *See, e.g.*, *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009).

The assumption makes absolutely no sense in the context of determining whether a royalty is consistent with a RAND commitment. Real-world negotiations take place in the shadow of uncertainty regarding validity and infringement. Assuming away that uncertainty unrealistically inflates the royalty.[24] Potential licensees would not have intended this outcome.

3. Rational Negotiators Account for External Factors That Affect Profitability

Common sense also says that royalty stacking concerns affect the reasonableness of a royalty. Proponents of the unmodified *Georgia-Pacific* methodology insist that royalty stacking concerns do not come into the analysis because such concerns are merely "theoretical."

But experience and common sense say that licensees take into account all potential costs when negotiating a patent license. A licensee that ignores potential royalty stacking merely because other essential patent holders have not yet enforced their patents is a fool. Granted, not all declared essential patents will be enforced. And, granted, not all patent holders that seek to enforce their declared essential patents will be able to obtain royalties. Experience has nonetheless shown that producers of standard-compliant products indeed end up paying royalties to multiple patent holders. Although it may be difficult to estimate the effect of royalty stacking, a methodology that simply ignores the potential for royalty payment to multiple patent holders simply defies common sense.

IV. CONCLUSION

Those debating what "reasonable" means in RAND have crafted intricate and complex arguments on both sides. If the touchstone for defining reasonable is what the parties intended, however, a bit of common sense can guide the way. If potential licensees intended to adopt an off-the-shelf *Georgia-Pacific* analysis, they gave away the farm. Common sense would have us conclude otherwise.

[24] *See* Edward F. Sherry & David J. Teece, *Royalties, Evolving Patent Rights, and the Value of Innovation*, 33 RESEARCH POL'Y 179, 183-85 (2004).