



THINK FORWARD

District Court Sets RAND Rate for Portfolio of Standard Essential Patents

October 07, 2013

In re Innovatio IP Ventures, LLC, Patent Litigation, No. 1:11-cv-09308 (N.D. Ill. Sept. 27, 2013)
Before Judge James F. Holderman in the U.S. District Court for the Northern District of Illinois

On September 27, 2013, Judge Holderman issued a Memorandum Opinion and Order in *In re Innovatio*, setting a reasonable and non-discriminatory (RAND) licensing fee for Innovatio's portfolio of nineteen patents essential to the 802.11 (Wi-Fi) standard. Judge Holderman is believed to be the second U.S. district court judge – following Judge Robart in *Microsoft Corp. v. Motorola, Inc.*, No. C10-1823, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013) – to have undertaken a judicial determination of a RAND licensing rate for a portfolio of standard essential patents (“SEPs”).

Findings on RAND Framework

Judge Holderman's 89-page opinion sets forth a fact-specific, evidence-based approach to determining a RAND royalty rate. The methodology employed by the *Innovatio* court generally follows Judge Robart's framework, requiring consideration of (i) the importance of the patent portfolio to the standard; (ii) the importance of the patent portfolio as a whole to the accused products; and (iii) other potentially comparable licenses. The court modified Judge Robart's methodology to fit the specific facts. First, rather than setting a RAND range for further consideration by a jury, the *Innovatio* court determined a single RAND rate. Second, because all asserted claims of Innovatio's asserted patents had previously been found to be essential, Judge Holderman assumed that the parties to the hypothetical negotiation would consider these patents to be valid and essential and, unlike Judge Robart, did not adjust the RAND rate in light of “pre-litigation uncertainty about the essentiality of a given patent.” Third, because the court utilized the Wi-Fi chip as the royalty base instead of the end products, it was not necessary to analyze the importance of Innovatio's patent portfolio to the accused products.

Calculating a RAND Royalty

The Parties' Proposed Methodologies: The parties disagreed upon the proper royalty base and method of apportionment for a RAND license to Innovatio's 802.11 SEPs. Innovatio argued that the RAND royalty should be calculated based upon (i) the average selling price of the accused products (laptops, tablets, access points, etc.), adjusted by a “Wi-Fi Feature Factor” to account for the value of the product attributed to the Wi-Fi functionality and (ii) a 6% benchmark royalty rate based upon allegedly comparable licenses. Innovatio's methodology would lead to licensing fees of \$3.39 per access point, \$4.72 per laptop, and up to \$16.17 per tablet.

Defendants, referred to collectively as “Manufacturers,” argued that the appropriate royalty base for 802.11 SEPs is the weighted average selling price of Wi-Fi chips, which provide 802.11 functionality to the accused products. Using a “Top Down” approach, the Manufacturers proposed a royalty equal to (i) the weighted average selling price of Wi-Fi chips; (ii) multiplied by the industry average profitability of Wi-Fi chipmakers, which would represent the cumulative potential royalties across all 802.11 SEPs; and (iii) further multiplied by one of several proposed ratios, depending on the court's finding of the

technological importance of the patents, to apportion the 802.11 royalty stack to Innovatio's SEPs. The Manufacturers' approach would lead to royalties of between 0.72 cents and 3.09 cents per chip.

The Court's Methodology: The *Innovatio* court utilized the Manufacturers' proposed methodology, with an adjustment to the royalty base from a weighted average chip price to an average price of a Wi-Fi chip over the life of Innovatio's patents. Importantly, Judge Holderman did not decide that the Manufacturers' methodology was the only correct method, only that it "best approximates the RAND rate that the parties to a hypothetical *ex ante* negotiation most likely would have agreed upon." Additionally, the court determined that Innovatio submitted no credible evidence that would allow the court to apportion the royalty base to the value of the patented features. Specifically, the "Wi-Fi Feature Factor," designed to reduce the royalty base to a value representing 802.11 functionality, was found to be "not based upon an established method of analysis, but [was] instead, speculative and subjective." Because the "Wi-Fi Feature Factor" was crucial to Innovatio's apportionment theory, the court found Innovatio's entire apportionment analysis to be unreliable.

Further, the court found Innovatio's proposed "6% benchmark royalty rate" to be unreliable, because "none of [Innovatio's] proposed licenses are in fact appropriate for a comparative analysis in the RAND context." Notably, however, the court rejected the Manufacturers' proposed comparable licenses as well, including licenses available from 802.11 patent pools. Commenting on the rejection of proposed comparable licenses, Judge Holderman noted the Federal Circuit's "skepticism about apportioning using comparable licenses." The court further suggested that "RAND licenses are relatively rare in the marketplace at this time" because "[c]ourts and participants in industries governed by standards have not focused on the RAND issue until recently."

The court then analyzed the technical importance of the asserted patents, looking at contribution to the standard over available alternatives at the time of adoption. Based on this analysis, the court concluded that the patents at issue were of "moderate to moderate-high" value to the standard, each falling into the top 10% most valuable patents to the standard. Finding that the top 10% of SEPs contribute over 84% of the value of the Wi-Fi standard, the court used this figure as a multiplier to the royalty base (84% of the average profit for a Wi-Fi chip). Ultimately, the court found a RAND licensing fee of 9.56 cents per Wi-Fi chip in the accused devices, which was a fraction of the rate sought by Innovatio.

Impact of the Decision

District courts have now begun to adjudicate RAND rates, assessing the value of a portfolio of SEPs to a standard, the value of the portfolio to the products, and the comparability of prior licenses to determine a RAND royalty rate. Judge Holderman, like Judge Robart before him, utilized a modified form of the *Georgia-Pacific* analysis, as well as existing Federal Circuit precedent of patent damages, as tools to guide the determination.

It remains to be seen how this body of law will develop. Companies involved with standardized technologies – including manufacturers, sellers, and users of most complex consumer electronic devices – would be well-advised to keep an eye on this issue. If you have any questions or wish to discuss how this decision may impact your company, please contact your attorney at Brinks Gilson & Lione.