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Ninth Circuit Holds That Qualcomm's Patent Licensing Program Does Not Violate U.S. Antitrust Law

Reversing District Court, Court of Appeals Finds That Qualcomm Did Not Have an Antitrust Duty to Deal with Rival Chipmakers and That Qualcomm's Licensing Practices Were Not Unlawfully Anticompetitive

SUMMARY

On August 11, 2020, in *FTC* v. *Qualcomm*,[1] the Ninth Circuit reversed the May 21, 2019 decision by Judge Lucy Koh of the U.S. District Court for the Northern District of California, which held that Qualcomm's patent licensing program was unlawfully anticompetitive, and vacated Judge Koh's permanent, worldwide injunction that had prohibited several of Qualcomm's core business practices. The Ninth Circuit held that: (i) Qualcomm did not have an antitrust duty to license its standard-essential patents to rival modem chip manufacturers; (ii) Qualcomm's patent license royalty rates were not unlawfully anticompetitive; and (iii) Qualcomm's other alleged conduct, including its "no license, no chips" policy, was not prohibited by the U.S. antitrust laws because it did not undermine competition in a relevant antitrust market.

BACKGROUND

Qualcomm develops, manufactures, and supplies semiconductor devices, known as "modem chips," that are used in cellphone handsets. Original equipment manufacturers ("OEMs"), such as cellphone manufacturers, must purchase and install modem chips in cellular handsets to enable them to communicate across cellular networks. Qualcomm also holds standard-essential patents ("SEPs") covering widely implemented cellular standards and is a member of two Standard-Setting Organizations ("SSOs") relevant to the case that require members to license their SEPs on fair, reasonable, and nondiscriminatory

("FRAND") terms. Because many of Qualcomm's SEPs are required for cellphones to practice certain industry standards, Qualcomm's rival chip manufacturers practice many of Qualcomm's SEPs.

In 2017, the Federal Trade Commission ("FTC") sued Qualcomm in the Northern District of California under Section 5 of the Federal Trade Commission Act,[2] which prohibits "unfair methods of competition," including those that may violate the Sherman Act. We previously described the district court's opinion in our memorandum dated May 24, 2019.

In its complaint, the FTC alleged that Qualcomm violated Section 5 of the FTC Act and Sections 1 and 2 of the Sherman Act by, among other things, refusing to license its SEPs to competing modem chip suppliers and instead only licensing to OEMs in violation of its FRAND commitments to SSOs, which the FTC alleged was intended to prevent OEMs from using modem chips supplied by Qualcomm's competitors. In addition, the FTC took issue with Qualcomm's "no license, no chips" policy—under which Qualcomm will not supply chips to an OEM unless it pays a royalty to Qualcomm for all of its device sales, regardless of whether they use a Qualcomm or other brand chip—alleging that this policy imposed an anticompetitive surcharge on rivals' chip sales. The FTC also alleged that Qualcomm had used the threat of cutting off access to Qualcomm chips to extract onerous patent licensing terms from OEMs, including unreasonably high royalties for cellphone handset devices.[3] Finally, the FTC alleged that Qualcomm harmed chip competitors by offering rebates on the royalties paid by certain OEMs (in particular, Apple) to induce them to enter into exclusive supply agreements with Qualcomm.

Pretrial, on November 6, 2018, Judge Lucy Koh granted the FTC's motion for partial summary judgment, holding that Qualcomm's FRAND commitments to two SSOs required Qualcomm to license its chip SEPs to rival chip suppliers. In January 2019, the court held a ten-day bench trial to determine whether Qualcomm's other patent licensing practices violated U.S. antitrust law. On May 21, 2019, Judge Koh issued a 233-page opinion in which she concluded that Qualcomm engaged in unlawfully anticompetitive conduct against both OEMs and chip rivals.[4] Qualcomm appealed, and the Ninth Circuit reversed.

THE NINTH CIRCUIT'S DECISION

The Ninth Circuit reviewed three primary questions: (1) whether Qualcomm had an antitrust duty to deal with rival chip manufacturers; (2) whether certain of Qualcomm's business practices, including its "no license, no chips" policy, were unlawfully anticompetitive; and (3) whether the district court's injunction was appropriate. Addressing each of the three questions noted above, the Ninth Circuit held that Qualcomm did not have an antitrust duty to deal with its competitors, that its business practices were not unlawfully anticompetitive, and that the district court's injunction was not warranted.[5]

Duty to Deal—*Aspen Skiing*. Although antitrust laws do not generally impose a duty to deal with competitors, Judge Koh found that the narrow exception created in the Supreme Court's decision in *Aspen Skiing* applied to Qualcomm.[6] The Ninth Circuit disagreed, noting that "the *Aspen Skiing* exception should be applied only in rare circumstances" and that the FTC had conceded that Judge Koh's reliance on the exception was not warranted.

The Ninth Circuit found that Judge Koh "ignore[d] critical differences" in three areas that distinguished Qualcomm's licensing program from the conduct that gave rise to a duty to deal in *Aspen Skiing*. *First*, the court found that Qualcomm, unlike the defendant in *Aspen Skiing*, did not terminate a voluntary and short-term profitable course of dealing to augment long-term profits.[7] Instead, Qualcomm stopped licensing chip manufacturers in response to developments in patent law's exhaustion doctrine—that would have made it difficult for Qualcomm to maximize its profits by licensing at the chip (as opposed to the handset) level. *Second*, the court found that Qualcomm's rationale for ending its licensing of rival chip manufacturers was not to sacrifice short-term profits for later gain, but to maximize both short- and long-term profits by pursuing a "far more lucrative [licensing program] . . . regardless of any impacts on competition."[8] *Third*, unlike in *Aspen Skiing*, the court found that there was no evidence that Qualcomm singled out "any specific chip supplier for anticompetitive treatment in its SEP licensing."[9]

Duty to Deal—*SSO Commitments.* The court then considered whether an antitrust duty to license rival chipmakers arose as a result of Qualcomm's FRAND commitments to the SSOs, and held that contractual FRAND commitments did not themselves create an antitrust duty to deal.[10] The court declined to decide whether Qualcomm was "contractually obligated via its SSO commitments to license rival chip suppliers," calling this a "conclusion we need not and do not reach."[11] The court noted, however, that "OEM-level [only] licensing polic[ies] . . . appear to be reasonable and consistent with industry practice" and could be justified on the ground that simultaneously licensing OEMs and chipmakers "would require the company to engage in 'multi-level licensing,' leading to inefficiencies and less profit."[12] Nevertheless, the court left open the question of whether Qualcomm's contractual FRAND commitments to the Alliance for Telecommunications Industry Solutions ("ATIS") and the Telecommunications Industry Association ("TIA") created a contractual duty to deal with rivals.

In addressing the antitrust issue, the Ninth Circuit held that even if Qualcomm had breached contractual FRAND commitments, that did not constitute anticompetitive conduct in violation of Section 2 under the facts of the case.[13] The court addressed three arguments made by the FTC:

First, the court rejected the FTC's claim that OEM-only licensing allowed Qualcomm to collect a surcharge from its rivals' customers, finding that Qualcomm's royalties could not injure competition in the relevant market because they are "chip-supplier neutral"—*i.e.*, Qualcomm collects royalties from all OEMs that license its patents, not just rivals' customers." The court also noted that the alleged harm was to OEMs, not to Qualcomm's competitors in the relevant antitrust markets identified by the district court (CDMA and LTE premium chips).[14]

Second, the court rejected the argument that Qualcomm's refusal to license its rivals deterred entry and investment in the relevant markets. Instead, it found that Qualcomm had created a route for competitors' entry by way of its "CDMA ASIC Agreements" with chip manufacturers that allowed them to sell chips to OEMs licensed by Qualcomm without fear of infringement litigation or the payment of royalties. The court found that these agreements "functionally act as de facto licenses . . . by allowing competitors to practice Qualcomm's SEPs before selling their chips to downstream OEMs."[15] The court also noted MediaTek's and Intel's entry into the modem chip market in the 2015–2016 timeframe, which suggested to the court that Qualcomm's OEM-level licensing policies did not undermine entry.[16] Moreover, the court found Qualcomm's "procompetitive justifications for its OEM-level licensing policy"—including that requiring a company license both at the OEM and chip-supplier levels simultaneously would require it to "engage in multi-level licensing leading to inefficiencies and less profit"—to be "reasonable and consistent with current industry practice."[17]

Third, the court distinguished the Third Circuit's decision in *Broadcom Corp.* v. *Qualcomm*[18], which held that a company's breach of its contractual commitments to an SSO may constitute an antitrust violation. The court found *Broadcom* inapplicable because it was based on an "intentionally false promise to license [SEPs] on FRAND terms . . . coupled with an [SSO's] reliance on that promise" and subsequent discriminatory pricing by the patentee.[19] Here, in contrast, neither intentional deception nor discriminatory pricing were alleged. The Ninth Circuit largely adopted the position advocated by the Antitrust Division of the U.S. Department of Justice—*i.e.*, *Broadcom* should be construed narrowly and a violation of a contractual FRAND commitment generally will not create antitrust liability.

Qualcomm's Other Conduct. The court next considered whether three other types of Qualcomm's conduct "harmed competition in the relevant markets" for CDMA and LTE chips.[20] In each case, the court found that it did not.

Unreasonable Royalty Rates as an Anticompetitive Surcharge. The district court found that Qualcomm's royalty rate (3%–5% of the handset price) for its patent license for any chip used by OEMs was unreasonably high, and as a result constituted a substantial anticompetitive chip-access surcharge that "excluded competitors from the marketplace and thereby harmed competition in general."[21] The Ninth Circuit characterized the district court's theory as (i) Qualcomm's royalty rate was unreasonably high, and thus (ii) the rate is "anticompetitive because it unreasonably raises costs to OEMs, who then pass along the extra costs to consumers and invest less in other handset features."[22] The Ninth Circuit found that this "fail[ed] to state a cogent theory of anticompetitive harm."[23]

First, the Ninth Circuit dismissed the district court's determination that the royalty rates were unreasonable, finding that it "misinterpret[ed] Federal Circuit law regarding both 'the patent rule of [reasonable royalty] apportionment'" and the smallest salable patent-practicing unit doctrine ("SSPPU").[24] Judge Koh had held as a matter of law that the reasonable royalty must be determined based on the value of the SSPPU. She determined the value of the SSPPU to be the price of the chip rather than the price of the cellular handset, which formed the base for the royalty rate imposed by Qualcomm's licensing practices.[25] The Ninth Circuit rejected that analysis, noting that "[n]o court has held that the SSPPU concept is a per se rule for 'reasonably royalty' calculations," that the Federal Circuit has specifically held that use of the SSPPU is *not* required to calculate patent damages, and that "[t]here is nothing inherently wrong with using the market value of the entire product."[26]

Second, the Ninth Circuit rejected the notion that royalties are anticompetitive *in the antitrust sense* simply because they may be unreasonable *under a patent law or FRAND analysis*. Specifically, the court "declin[ed] to adopt a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the 'fair value' of its SEP portfolios correspond to the prices the market appears willing to pay for those SEPs in the form of licensing royalty rates."[27]

Third, the Ninth Circuit found that, even assuming a deviation between a patent's intrinsic value and its licensing royalty rate, any resulting anticompetitive harm was to OEMs, not chip manufacturers—*i.e.*, the harm was to Qualcomm's customers, not its competitors.[28] Thus, any alleged anticompetitive harm was outside the relevant markets defined by the district court.

Fourth, the Ninth Circuit held that, even if the rates were unreasonable, they did not impose an "artificial" surcharge on chips. Distinguishing *Caldera, Inc.* v. *Microsoft Corp.*[29]—the primary case referenced by the district court—the appellate court found that Qualcomm's patents have independent value and are necessary to the OEM's ability to market and sell products practicing the technology, regardless of whether Qualcomm's chips or those of its rivals are used by the OEM.[30]

Finally, the Ninth Circuit rejected the FTC's "margin squeeze" theory of anticompetitive conduct—that Qualcomm charged "ultralow" prices on its modem chips, which it recouped through its patent license royalties. Judge Koh had found that Qualcomm's low chip prices pushed out rivals by "squeezing their profit margin and preventing them from making necessary investments in research and development."[31] But the Ninth Circuit found that, under the Supreme Court's decision in *linkLine Communications*,[32] this theory was precluded by the FTC's failure to present any evidence of predatory pricing by Qualcomm (*i.e*., below an appropriate measure of Qualcomm's cost).

"No License, No Chips" Policy. Judge Koh found that Qualcomm's practice of refusing to sell its chips to OEMs unless they also took a license to its SEPs for all chips used by the OEM was "anticompetitive conduct against OEMs" and an "anticompetitive practice[] in patent license negotiations."[33] The Ninth Circuit noted, however, that "neither the Sherman Act nor any other law" prohibits companies from licensing patents independent of chip sales or selling their chips only to licensed OEMs. The policy as implemented by Qualcomm only created "potential harms to Qualcomm's *customers*, not its competitors, and thus f[ell] outside the relevant antitrust markets."[34] Thus, the court explained, even if Qualcomm's policy raised the

all-in price (chipset + licensing royalties) paid by OEMs to an unreasonable level regardless of which supplier the OEM used to source its chips, its conduct was not within the purview of antitrust law because it harmed only Qualcomm's customers, not its rivals. The court contrasted this with a hypothetical "no chips, no license" policy (*i.e.*, if Qualcomm were to refuse to license its SEPs to OEMs unless they first agreed to purchase Qualcomm's chips), which the court suggested might be anticompetitive because it would force OEMs to either purchase Qualcomm's chips or pay for both Qualcomm's and a competitor's chip.[35]

Exclusive Dealing and Volume Discounts. The district court had held that certain supply and marketing contracts between Qualcomm and Apple in 2013, taken together, constituted a *de facto* exclusive dealing arrangement that "foreclosed a 'substantial share' of the [CDMA] modem chip market."[36] Although the court found merit in Judge Koh's determination that the Apple agreements were structured as exclusive dealing contracts, it held that the agreements did not have the "actual or practical effect of substantially foreclosing competition in the CDMA modem chip market" because Intel won Apple's business in 2014, and "[t]here was no indication . . . that Intel was a viable competitor prior to 2014–2015, or that the 2013 agreement delayed Apple's transition to Intel by any more than one year."[37]

The District Court's Nation-Wide Injunction. Having found that none of Qualcomm's licensing practices violated the Sherman Act and that exclusive dealing agreements (like those with Apple) were past wrongs, the Ninth Circuit held that "there is nothing to be enjoined" and vacated the district court's injunction.[38]

IMPLICATIONS

The Ninth Circuit's decision, unless modified by the Supreme Court, affirms Qualcomm's SEP licensing model for OEMs (and its refusal to license rival chipmakers), at least with respect to any challenge under U.S. antitrust laws. Because Qualcomm's model has driven the cellular modem licensing and sale landscape for chip suppliers and handset makers alike, the court's decision will likely quiet concerns on the part of some that the district court's decision would upend that market, although it perhaps makes it less likely that the market will see increased competition or that chip prices will drop as may have been the case if Judge Koh's injunction had been upheld.

Although the court confirmed that an SEP holder has no antitrust duty to deal with rivals outside the limited *Aspen Skiing* exception, the Ninth Circuit left open the possibility that an SEP holder's FRAND commitments may obligate it to deal with its rivals.[39] Importantly, however, the Ninth Circuit clarified that a company's breach of its FRAND commitments does not amount to anticompetitive conduct in violation of the Sherman Act. Instead, the remedy for such conduct lies in contract law. Moreover, the court's decision to vacate as moot the district court's summary judgment decision—which found that Qualcomm was required by its FRAND commitments to license rival chipmakers—removes what some had considered to be persuasive judicial authority in the U.S. supporting a claim that FRAND requires licensing at all levels of a product distribution chain which implement a standard. This is noteworthy for SEP holders because it returns U.S.

jurisprudence to the *status quo*, and at least one court in the Eastern District of Texas interpreted a comparable FRAND commitment as not requiring a SEP holder to license all comers at any level of the supply chain. This issue continues to be litigated in the U.S., notwithstanding the Department of Justice Antitrust Division general view that the market, not FRAND, should determine license structures.

The court's refusal to force licensing at the chip level (rather than the OEM level) also may ease concerns that patent-exhaustion considerations could be used to limit SEP licensors' ability to maximize profits if licenses were required at the chip level. The Ninth Circuit confirmed that royalty rates are not required to be set strictly using the SSPPU and recognized that "OEM-level licensing is now the industry norm."[40] The Ninth Circuit also recognized that "[t]here are good reasons for SEP owners to structure their licensing programs to license end-user products."[41] The court's findings appear consistent with current flexibility in structuring FRAND licensing programs.

The Ninth Circuit's decision also recognizes that royalty rate determinations, and particularly the determination of a FRAND rate, are an issue that sounds in patent law, not antitrust law. The court "decline[d] to adopt a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the 'fair value' of its SEP portfolios corresponds to" what the market is willing to pay for those SEPs in royalty rates.[42] Arguably, the Ninth Circuit's decision will impact negotiation power between patent owners and technology implementers by clarifying the circumstances under which patent licensing conduct will give rise to antitrust liability.

Finally, the Ninth Circuit's decision is noteworthy beyond its application to SEP licensing because it recognizes and demonstrates that courts should be reluctant to ascribe antitrust liability based on conduct occurring in a dynamic, rapidly evolving market—a characterization that will apply to many existing and emerging technology markets.

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ENDNOTES

1 *FTC* v. *Qualcomm Inc.* (hereinafter "*Qualcomm III*"), Case No. 19-16122, ECF No. 255-1 (9th Cir. Aug. 11, 2020).

2 15 U.S.C. § 45, *et seq*.

3 As discussed in our client memorandum, dated January 10, 2019, this determination stands in contrast to the conclusion reached by the Eastern District of Texas in *HTC Corp.* v. *Telefonaktiebolaget LM Ericsson*.

4 *FTC* v. *Qualcomm Inc.*(hereinafter "*Qualcomm I*"), 411 F. Supp. 3d 658 (N.D. Cal. 2019).

5 *Qualcomm III,* Case No. 19-16122, ECF No. 255-1 at 56.

6 *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). Under *Aspen Skiing*, a duty to aid rivals may be imposed only where: (i) the defendant unilaterally terminated a voluntary and profitable course of dealing; (ii) the only conceivable rationale for terminating its course of dealing is to sacrifice short-term profits to obtain higher profits in the long run from the exclusion of competition; and (iii) the product the defendant refused to provide to its competitor was already being sold in the retail market to other customers. *Id.*

7 *Qualcomm III,* Case No. 19-16122, ECF No. 255-1 at 33–34.

8 *Id.* at 34 (internal quotation marks omitted).

9 *Id.* at 35.

10 *Id.* at 36.

11 *Id.* at 36.

12 *Id.* at 37–38.

13 *Id.* at 36, 40 (noting that the FTC failed to "explain how Qualcomm's alleged breach of this contractual commitment *itself* impairs the opportunities of rivals").

14 *Id.*

15 *Id.* at 37.

16 *Id*. The Court also credited Qualcomm's procompetitive justification, which was supported by amici Nokia and Dolby, that licensing at the OEM and chip-supplier levels simultaneously would require the company to engage in "multi-level licensing," leading to inefficiencies and reduced profit. *Id.* at 37 & n.17.

17 *Id.* In support of this point, the Ninth Circuit relied, in part, on Dolby Laboratories, Inc.'s Amicus Brief prepared by Sullivan & Cromwell. *See id.* at 37 n.17.

18 *Broadcom Corp.* v. *Qualcomm Inc.*, 501 F.3d 297, 314 (3rd Cir. 2007).

19 *Qualcomm III,* Case No. 19-16122, ECF No. 255-1 at 38 (quoting *Broadcom Corp.* v. *Qualcomm Inc.*, 501 F.3d 297, 314 (3rd Cir. 2007)).

20 *Qualcomm I*, 411 F. Supp. 3d at 695–96.

21 *Id.* at 791.

22 *Qualcomm III,* Case No. 19-16122, ECF No. 255-1 at 41.

23 *Id.* at 41.

24 *Id.* at 42–43.

25 *Id.* at 42.

ENDNOTES (CONTINUED)

26 *Id*. at 42–43; *see also Commonwealth Sci. & Indus. Research Org.* v. *Cisco Sys., Inc.*, 809 F.3d 1295, 1303 (Fed. Cir. 2015) ("The rule Cisco advances—which would require all damages models to begin with the [SSPPU]—is untenable [and] conflicts with our prior approvals of a methodology that values the asserted patent based on comparable licenses.").

27 *Qualcomm III*, Case No. 19-16122, ECF No. 255-1 at 44.

28 *Id.*

29 87 F. Supp. 2d 1244 (D. Utah 1999).

30 *Qualcomm III*, Case No. 19-16122, ECF No. 255-1 at 46.

31 *Id.* at 46.

32 *Id.* at 47; *see also Pac. Bell Tel. Co.* v. *linkLine Commc'ns, Inc.*, 555 U.S. 438, 451–52, 457 (2009).

33 *Qualcomm III,* Case No. 19-16122, ECF No. 255-1 at 48.

34 *Id.* at 49.

35 *Id.* at 50.

36 *Id.* at 51.

37 *Id.*

38 *Id.* at 56.

39 *Id.* at 36.

40 *Id.* at 13 n.5.

41 *Id.*. at 37 n.17.

42 *Id.* at 44.

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