

November 8, 2018

District Court Holds That FRAND Commitment Requires Patent Owner to “License All Comers,” Including Chip Makers

Northern District of California Grants Summary Judgement That Qualcomm Must License Its Standard-Essential Patents at Chip Level

SUMMARY

On November 6, 2018, in *FTC v. Qualcomm*,¹ the U.S. District Court for the Northern District of California granted the Federal Trade Commission’s motion for partial summary judgment, holding that FRAND licensing obligations imposed by two standard-setting organizations on participating patentees required Qualcomm to license its patents essential to practicing 3G and 4G/LTE telecommunications standards to competing modem chip suppliers.

BACKGROUND

The adoption of technological standards by standard-setting organizations enables product compatibility across an array of consumer products deploying such standards regardless of the source of such products. In cellular communications, for example, standardization allows an iPhone to communicate seamlessly with a Samsung Galaxy handset, and either device to communicate with the same base station constructed by one or more service providers. Standards also encourage companies to develop new standard-compliant technologies and products, by fostering an ecosystem in which those products may be sold. However, when standards include patented technologies (thereby making the patent a standard-essential patent (“SEP”)), owners of SEPs may be in a position to exercise disproportionate bargaining power over implementers of the standards, including the SEP owner’s competitors, who also

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wish to make and sell products based on the standard. This may lead to patent “hold-up,” through which the owner of a SEP demands a disproportional royalty for its SEPs or threatens to block the implementation of the standard by others.

To combat the threat of hold-up, Standard-Setting Organizations (“SSOs”) have created intellectual property rights (“IPR”) policies that require SEP holders, in exchange for the opportunity to participate in the standard-setting process and benefit from the possibility that their technology may be incorporated in a standard, to agree to license their patents on terms that are “fair, reasonable, and nondiscriminatory,” or FRAND. To date, a number of courts have held that such IPR policies create a contractual obligation, enforceable by standards implementers, on patent owners to license their SEPs on FRAND terms.²

Qualcomm develops, manufactures, and supplies semiconductor devices, known as “modem chips,” that are used in cellphone handsets. Qualcomm also holds SEPs to widely adopted cellular standards, including the 3G and 4G/LTE standards promulgated by the SSOs at issue in the case, the Telecommunications Industry Association (“TIA”) and the Alliance for Telecommunications Industry Solutions (“ATIS”).

In 2017, the FTC sued Qualcomm under § 5 of the Federal Trade Commission Act,³ which prohibits “unfair methods of competition,” including those that may violate the Sherman Act. The FTC alleged that Qualcomm violated § 5 and harmed competition by, among other things, refusing to license its SEPs to competing modem chip suppliers. Instead of licensing at the “chip level,” Qualcomm generally licenses to only handset manufacturers who use modem chips. The FTC alleged that this policy was intended to prevent handset manufacturers from using modem chips supplied by Qualcomm’s competitors. Because manufacturers would not be licensed under Qualcomm’s SEPs, they generally would avoid purchasing such chips. Following discovery, the FTC moved for partial summary judgment that Qualcomm’s FRAND commitment, under the IPR policies of TIA and ATIS, required Qualcomm to license its essential patents to competing modem chip suppliers.⁴

THE COURT’S DECISION

Judge Koh, granting the FTC’s motion, applied California contract law to Qualcomm’s FRAND commitment to TIA and ATIS, and found that Qualcomm was contractually obligated to license its SEPs on FRAND terms to all implementers of the standard seeking a license.⁵ According to Judge Koh, the text of the FRAND commitment, interpreted in light of the IPR policies of the two SSOs, set out a clear obligation to license all, and prohibited discrimination among standards implementers regardless of their place in the product distribution chain.⁶

The court determined that both IPR policies included “non-discrimination provisions that prohibit Qualcomm from distinguishing between types of [license] applicants.”⁷ In pertinent part, the TIA IPR policy required a SEP holder to license to “all applicants,” and the ATIS IPR policy similarly demanded

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assurances from the SEP holder to make licenses available to “applicants” under terms “demonstrably free of any unfair discrimination.”⁸

The court also relied on Ninth Circuit precedent to determine the meaning of the SSO “non-discrimination” language. Judge Koh found that the Court of Appeals for the Ninth Circuit, in analyzing “almost identical language” from another IPR policy in its *Microsoft* decision, had held that the FRAND commitment creates “an obligation to license to all comers”;⁹ in other words, it “requir[ed] members who hold IP rights in standard-essential patents to agree to license those patents *to all comers* on terms that are ‘reasonable and nondiscriminatory[.]’”¹⁰ Judge Koh noted that the Ninth Circuit had reiterated this “same core principle” a subsequent decision, where it held that a “SEP holder *cannot refuse* a license to a manufacturer who commits to paying the [F]RAND rate.”¹¹ Based on these precedents and the language of both the FRAND commitment to TIA and ATIS, Judge Koh held that “a SEP holder that commits to license its SEPs on FRAND terms must license those SEPs to all applicants.”¹²

While perhaps not a “core” holding of the opinion, Judge Koh also discussed the competitive effects of Qualcomm refusing to license rival chip manufacturers. Judge Koh noted that, by refusing to license competitors, Qualcomm threatened to lock such competitors out of the markets for providing chips that enable products to implement the relevant technologies, allowing Qualcomm thereby to achieve or further its monopoly.¹³

In reaching these conclusions, the court rejected Qualcomm’s argument that none of the Ninth Circuit precedents had determined whether chip makers constituted standards “implementers” who were the beneficiaries of the FRAND licensing commitment. Specifically, Qualcomm argued that only “devices”—not modem chips—“practice” or “implement” the standards.¹⁴ Judge Koh responded that the TIA and ATIS IPR policies did not require practice or implementation of the standards *as a whole*, and that the practice or implementation of “portions” or “elements” of a standard can fall within the SSO’s IPR policies.¹⁵ The court also relied on certain Qualcomm admissions that chips in fact implemented the standards at issue, and found it significant that Qualcomm was “unable to identify *any* court that has made a contrary statement about the scope of a SEP holder’s FRAND commitments.”¹⁶

Finally, Judge Koh rejected Qualcomm’s assertion that industry practice regarding telecommunications standards was to license device manufacturers, not chip makers, and that the relevant SSO FRAND policies should be interpreted in light of this custom and usage.¹⁷ The court pointed to evidence that Qualcomm itself (a modem chip supplier) had boasted of having multiple licenses to SEPs,¹⁸ likely as a result of the mandatory grant-back provisions of its licenses (also a subject of FTC challenge). Judge Koh did not otherwise address whether industry practice could be used to interpret the nature of Qualcomm’s contractual FRAND licensing promise.

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In sum, the district court granted the FTC's motion for partial summary judgment, holding that "a SEP holder that commits to license its SEPs on FRAND terms must license those SEPs to all applicants,"¹⁹ and cannot decide "where on the value chain they choose to license."²⁰

IMPLICATIONS

Judge Koh's decision, if it stands on appeal (there are reports of a potential Qualcomm-FTC settlement that would avoid any such appeal),²¹ could upend many standard licensing practices of SEP owners, and careful consideration of the decision will be required in connection with any attempt to design or modify a SEP licensing program. Many have previously understood the non-discrimination aspect of the FRAND commitment to require that similarly situated licensees be treated similarly, but not that every potential licensee in the distribution chain must be treated identically. Patentees have structured their licensing programs accordingly.

Licensing programs that license only at the device manufacture level have done so for multiple reasons, including (i) a patentee's desire to license at a level in the product distribution chain at which its patents achieve the highest market value; (ii) the difficulty of determining whether a product is in fact licensed only once if licenses are granted to multiple components that ultimately comprise a consumer product; and (iii) difficult questions (that may be costly to resolve) that may arise regarding whether, for example, an invention is embodied in the chip, or the chip plus software, or requires the chip, plus software, plus other components of the device to constitute infringement. It remains to be seen whether other courts may afford more consideration to these arguments, or how they may be addressed on any appeal.

The court also did not address the impact of its decision on patent-licensing practices when considered in conjunction with the Supreme Court's patent exhaustion doctrine. To the extent modem chip competing manufacturers are granted licenses to sell their products under Qualcomm's patents, Qualcomm's patent rights may be exhausted with respect to handset manufacturers who use the now-licensed competing chips, because in many circumstances the "initial authorized sale of a patented item terminates all patent rights to that item."²² It is thus possible that one result of the decision may be that those who implement a standard by selling finished consumer products may contend that they no longer need a license to the SEPs that cover that standard if such manufacturers can point to identifiable licensed component suppliers who provide a partial embodiment of the inventions claimed in those SEPs.

It remains far from clear that SEP owners will now be compelled to license at the chip level, or if so, under what conditions. Topics that are likely to be hotly debated as a result of the court's decision include (i) whether a royalty at the chip level can (or as a result of the non-discrimination obligation must) be the same as the royalty charged at the device level; (ii) the extent to which the court's decision is limited by the special nature of Qualcomm's role as a chip manufacturer and the effect of its no-chip-license policy on competition; (iii) whether industry practice by licensors who do not have the network of chip licenses

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that Qualcomm has impacts the interpretation of their contractual FRAND obligations; and (iv) whether the result reached by Judge Koh will be different for FRAND obligations and IPR policies that are not governed by California law.

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ENDNOTES

- 1 17-cv-00220, Dkt. No. 792 (N.D. Cal. Nov. 6, 2018).
- 2 *See, e.g., Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872 (9th Cir. 2012); *Microsoft Corp. v. Motorola, Inc.*, 795 F.3d 1024 (9th Cir. 2015).
- 3 15 U.S.C. § 45.
- 4 *FTC v. Qualcomm Incorp.*, 17-cv-00220, Dkt. No. 792, at 1 (N.D. Cal. Nov. 6, 2018).
- 5 *Id.* at 16–17.
- 6 *Id.* at 19.
- 7 *Id.*
- 8 *Id.*
- 9 *Id.* at 17 (discussing *Microsoft*, 696 F.3d at 875).
- 10 *Id.* (quoting *Microsoft*, 696 F.3d at 876).
- 11 *Id.* (quoting *Microsoft*, 795 F.3d at 1031).
- 12 *Id.* at 18.
- 13 *See id.* at 20–21.
- 14 *Id.* at 23.
- 15 *Id.* at 23–24.
- 16 *Id.* at 18–19, 23.
- 17 *See id.* at 21–25.
- 18 *Id.* at 21.
- 19 *Id.* at 18.
- 20 *Id.* at 25 (internal quotation marks omitted).
- 21 Indeed, the FTC and Qualcomm filed a “joint administrative motion to defer the Court’s ruling” that the court denied. *Id.* at 7.
- 22 *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008).

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