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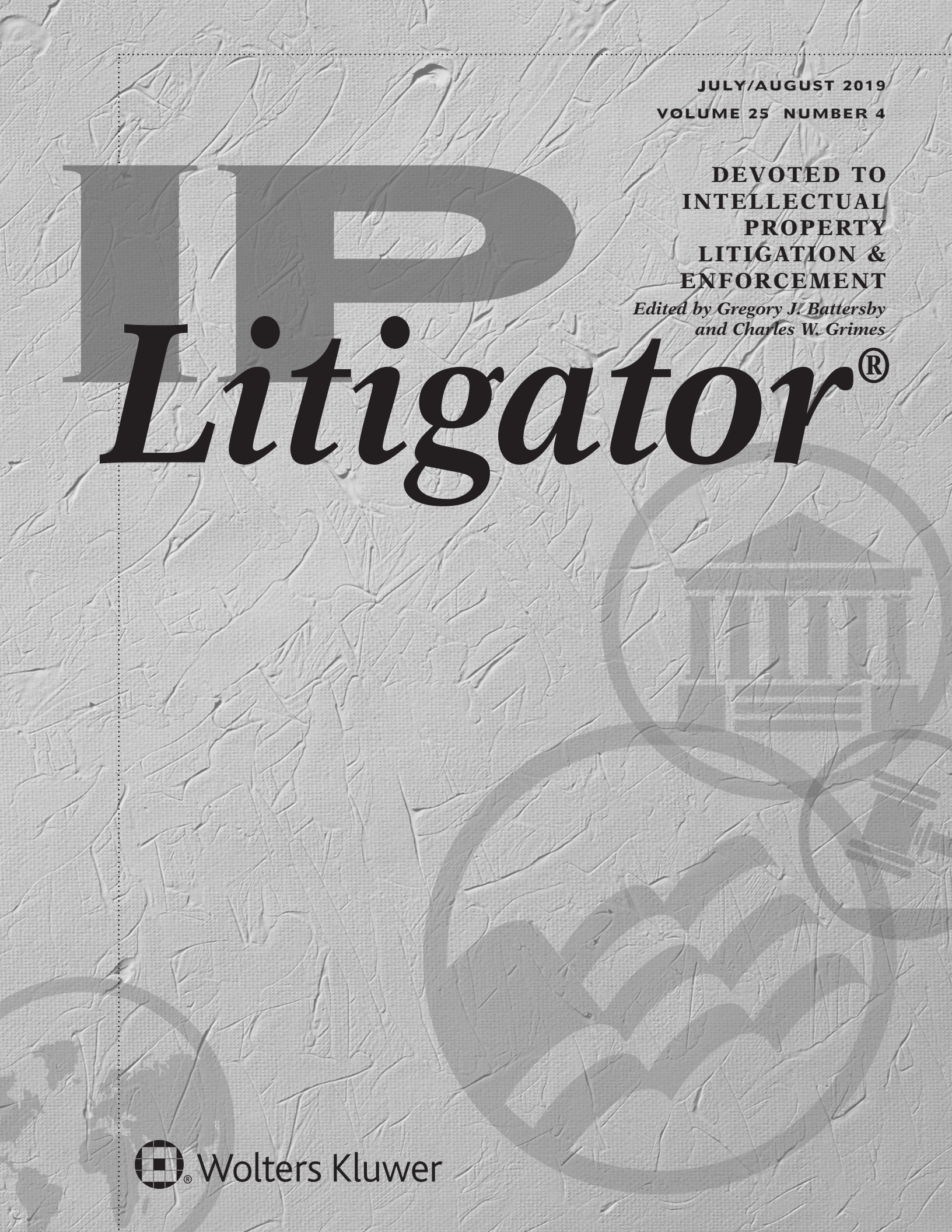

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District Court Decision in FTC v. Qualcomm *Spawns Controversy: Four Issues to Watch on Appeal*

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The recent ruling by a California federal court in the Federal Trade Commission's monopolization case against Qualcomm sparked immediate and strong reactions from varied quarters.[1] In a lengthy opinion, the court held that Qualcomm violated federal antitrust law. It ordered a broad injunction that could alter Qualcomm's business model just as the global cellular system transitions to 5G. Qualcomm has appealed to the Ninth Circuit.

The case has been controversial from the outset. The FTC first voted to file the complaint by a 2-1 vote under Chairwoman Edith Ramirez in January 2017. Then Commissioner, and later Acting Chairman, Maureen Ohlhausen, went against her usual practice and issued a public dissent in a case heading to court. In another unusual move, shortly before the district court ruled, the Antitrust Division of the United States Department of Justice filed an unsolicited statement of interest to urge the court, if it were to find liability, to require additional briefing and a hearing on remedies before issuing an order.[2]

When the court finally issued its order, it was not surprising to see Bruce Hoffman, the FTC Bureau of Competition Director supervising the case, hail the decision as "an important win for competition in a key segment of the economy."[3] It, however, was unusual to see sitting FTC Commissioner Christine Wilson follow with an op-ed for the Wall Street Journal condemning the decision as a "dangerous antitrust overreach" that will "create new legal obligations, undermine intellectual-property rights, and expand the application of our antitrust laws beyond U.S. borders," while her colleagues Commissioners Rohit Chopra and Rebecca Slaughter issued statements praising the decision as "a thorough accounting," "meticulous," and a huge victory "for every

American who believes in competitive markets."[4] When it comes to this case, the Commission appears to remain starkly split.

Beyond the controversy and potential implications for Qualcomm and the global cellular ecosystem, the case raises important antitrust questions for firms that own or use standard-essential patented technologies, as well as firms in any sector that use conditional rebates or incentive pricing as part of their competitive strategy. The court's roving 233-page decision is dense with factual findings and credibility determinations, but spare by comparison in its legal and economic analysis of the FTC's complex and interrelated theories of harm—theories that could ripple well beyond this case. We expect that the most important issues will narrow as the case now moves to the Ninth Circuit Court of Appeals, where the district court's findings and legal analysis will be scrutinized.

Background

In January 2017, the FTC filed an antitrust complaint against Qualcomm in the Northern District of California. The complaint alleged that Qualcomm had unlawfully monopolized two markets for modem chips (also called baseband chips or processors)—semiconductors that, together with other components, allow devices like smartphones and tablets to communicate over cellular networks. The affected markets were alleged to be based on the wireless technology they supported: CDMA (3G) and premium-quality LTE (4G) modem chips. The FTC claimed that Qualcomm maintained its dominant market position by (1) requiring modem chip customers to license its patents separately before it would sell them chips (what the FTC called the "no license—no chips" policy), (2) declining to license its standard-essential patents to competing modem chip suppliers, and (3) utilizing *de facto* exclusive dealing arrangements with Apple. The FTC claimed that Qualcomm's conduct was anticompetitive and violated Section 5 of the FTC Act.

There were two important preliminary rulings. First, the court denied Qualcomm's motion to dismiss, finding that the FTC had alleged valid antitrust claims under each of its three theories. Then on November 6, 2018, the court granted the FTC's motion for partial summary judgment, holding that, as a matter of contract law, Qualcomm had to provide licenses on fair, reasonable, and nondiscriminatory (FRAND) terms to all applicants (including its modem chip rivals) for any patents declared under the patent policies of two U.S. standards development organizations (SDOs)—the Telecommunications Industry Association (TIA) and the Alliance of Telecommunications Industry Solutions (ATIS). The FTC did not ask the court to rule on Qualcomm's contractual obligations to other SDOs, and the court's order was therefore limited to Qualcomm's obligations under the TIA and ATIS policies.

The District Court Decision

The court held a 10-day bench trial in January 2019 and issued its decision on May 21, ruling in favor of the FTC.[5] The court began its analysis by defining separate relevant markets for CDMA and "premium" LTE modem chips (chips that provide the functionality to support high-end smartphones that operate on LTE networks). That issue was critical to the FTC's case because Qualcomm's market share led the court to conclude it had monopoly power in both markets.

Turning to the FTC's three main theories of harm, the court first found that Qualcomm required that its CDMA and premium LTE modem chip customers (the OEMs) separately license Qualcomm's patented technology, rather than exhausting those rights through the sale of the chips themselves. According to the court, "Qualcomm concedes [its policy] is unique within Qualcomm and unique in the industry."[6] Relying primarily on documentary evidence, the court found that Qualcomm had used the threat of a chip supply disruption to advance its patent licensing negotiations. Using what the court characterized as a "carrot and stick" strategy, it found that Qualcomm had engaged in "anticompetitive conduct against OEMs" by using its market power in CDMA and LTE modem chips to secure higher royalty rates, but also sometimes providing conditional rebates on chip sales that created near-exclusive supply arrangements.

The court then evaluated the FTC's claim that Qualcomm was required (pursuant to its assurances to TIA and ATIS, as well as under the antitrust laws) to license its modem chip rivals and that its failure to do so harmed competition. The court found that Qualcomm had not been willing to provide an exhaustive license to its rivals to manufacture and sell chips, though it typically offered an accommodation that was less likely to exhaust its rights to license OEMs directly, such as a mutual nonassertion agreement, covenant not to sue, or a limited license that would allow the rival to supply chips to Qualcomm-licensed OEMs. However, consistent with its earlier ruling on the FTC's motion for partial summary judgment, the court found these more limited offers insufficient under Qualcomm's contractual obligations to TIA and ATIS. The court also found that Qualcomm had a separate antitrust duty to deal with its rivals under the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*[7] The court found that by

breaching these duties, Qualcomm imposed unjustified costs on its rivals and harmed competition.

With regard to the FTC's third theory of harm—*de facto* exclusive dealing arrangements with Apple—the court focused on a 2011 Transition Agreement and a 2013 First Amendment to Transition Agreement. In 2011, as Apple was planning to launch a premium LTE handset, Apple and Qualcomm entered into an agreement that provided Apple with substantial new incentive payments to encourage its transition to Qualcomm chips. The payments were conditioned on Apple meeting volume targets and subject to termination, or in some cases repayment, if Apple sold products using non-Qualcomm modem chips. The parties expanded their relationship again in 2013, amending the 2011 Transition Agreement to provide for additional conditional incentive payments for Qualcomm chips used in iPhones and iPads.

The court found that the 2011 and 2013 agreements were *de facto* exclusive dealing arrangements because the agreements "coerced" Apple into purchasing a substantial portion of its supply from Qualcomm. The court ruled that the agreements harmed competition by foreclosing a substantial share of the market to rivals and depriving rivals of other benefits that would allow them to gain a foothold in the market. These additional benefits included revenue to fund R&D, exposure to Apple's engineering expertise, reputational benefits that would boost opportunities with other OEMS, and an enhanced standing within SDOs. It is worth noting, however, that the court also found that while Apple explored potential supply arrangements with multiple alternative modem chip suppliers in 2011 and 2012, "only Intel proved to be a viable Qualcomm alternative."[8] The court found that just prior to execution of the 2013 agreement, Apple decided to "test run" an Intel modem chip in a new iPad model, but postponed those plans after signing the new agreement with Qualcomm. Apple began sourcing chips from Intel in 2016, using Intel modem chips exclusively in its 2018 handsets.[9]

The District Court Injunction

Having found that Qualcomm violated the FTC Act, the court ruled that Qualcomm's anticompetitive conduct is ongoing and that an injunction is warranted. Moreover, the court looked beyond past competitive effects in the CDMA and LTE markets at issue in the case and concluded that Qualcomm "is likely to replicate its market dominance during the transition to 5G, the next generation of modem chips."[10] The court issued a broad injunction, which could require substantial changes to Qualcomm's business model and require ongoing government oversight of the company. The key aspects of the injunction would:

- Prohibit Qualcomm from conditioning the supply of modem chips or technical support on a customer's patent-license status.
- Require Qualcomm to negotiate licenses (and renegotiate existing licenses) without any risk of disruption to a customer's modem chip supply.
- Require Qualcomm to make exhaustive licenses to its standard-essential patents available to modem chip suppliers on FRAND terms.
- Prohibit Qualcomm from interfering with any customer's ability to communicate with a government agency about a potential law enforcement or regulatory matter.
- Prohibit Qualcomm from entering express or *de facto* exclusive dealing arrangements for the supply of modem chips.
- Require Qualcomm to adhere to FTC compliance and monitoring procedures.

However, although the court criticized Qualcomm's licensing terms, including using the handset device as the royalty base, the injunction does not mandate any particular licensing terms nor require that concluded licenses be based on the smallest saleable patent-practicing unit. Qualcomm has appealed to the Ninth Circuit.

Four Issues to Watch on Appeal

Both the legal and political interest in this case will likely grow as the case moves through appeal. On the substantive antitrust questions that will be before the Ninth Circuit, the following four issues will be particularly important to watch.

1. *"No License—No Chips": Excessive Pricing or Anticompetitive Exclusion?*

As discussed above, the core of the FTC's case revolves around Qualcomm's practice of selling modem chips nonexhaustively and requiring that OEMs license the patent rights separately. The court devoted the largest number of pages to describing evidence it found persuasive in showing that Qualcomm had used its market power in chips to pressure OEMs to sign licenses. But the court's analysis of how that behavior was more than the lawful exercise of monopoly power is elusive. While "excessive pricing" can be a factor in an antitrust claim in

some jurisdictions, including the European Union, illegal monopolization under U.S. antitrust law requires anticompetitive exclusion of rivals, not the mere exercise of market power obtained lawfully, by, for example, developing and marketing a superior product.

This critical distinction led the D.C. Circuit to rule against the FTC in its last monopolization case involving standard-essential patent licensing.[11] Yet, the source of the exclusionary effect here is murky. The court cites to just one instance where a Qualcomm license required a higher royalty on units incorporating a rival chip—a term that was eliminated when the license was renewed three years later.[12] In all other cases, it appears that OEMs paid the same royalty rate regardless of the source of the chip in the licensed device, putting a question mark over the FTC's claim, which the court appears to have accepted, that Qualcomm's policy created a cost disadvantage for rivals.

2. *Antitrust Duty to License IP to Competitors?*

The court concluded that Qualcomm had an antitrust duty to license its modem chip rivals under the Supreme Court's decision in *Aspen Skiing*, relying heavily on the fact that Qualcomm had previously licensed its rivals, but later determined that it was more profitable to license solely at the OEM level. It is unclear from the evidence cited in the opinion what role changes in the U.S. law on patent exhaustion may have had on Qualcomm's licensing practices over time. But beyond that key factual question, there are purely legal reasons to question the court's embrace of *Aspen Skiing* to impose a duty to license intellectual property given that the case did not involve the licensing of intellectual property. Moreover, the Federal Circuit has held that the antitrust laws do not impose any duty to share intellectual property and the relevant Ninth Circuit precedent has been widely criticized.[13]

3. *Implications for SDO FRAND Policies?*

The court also opined on the obligations of standard-essential patent owners who have provided voluntary licensing assurances to SDOs. The Federal Circuit has held that licensing obligations must be evaluated by reference to the specific SDO policy at issue.[14] Consistent with that analysis, the FTC moved for summary judgment on Qualcomm's contractual obligations under the patent policies of two specific SDOs—TIA and ATIS. The court evaluated the FTC's motion under principles of California contract law and ruled that, under those two policies, Qualcomm was required to provide a license on FRAND terms to all applicants, including its modem chip rivals. However, in the current order, though not necessary to support the decision, the court painted with a broader brush, suggesting that its earlier ruling applies to a licensing assurance to any SDO policy that includes the phrase "fair, reasonable, and nondiscriminatory." The court made that shift in its analysis based solely on dicta in two Ninth Circuit decisions in *Microsoft Corp. v. Motorola*, a case that involved a FRAND royalty rate dispute between a standard-essential patent owner and an OEM that did not raise the question of component-level licensing—the subject of the court's order on the TIA and ATIS policies.[15] The court also claimed that Qualcomm's practice of using the value of the handset (rather than the chip) as the royalty base is inconsistent with Federal Circuit law, but did so without citing to the Federal Circuit's decision in *CSIRO v. Cisco*,[16] which held that in calculating reasonable royalties, principles of apportionment do not mandate a particular royalty base. However, the fact that the injunction does not mandate either royalty rates or a particular royalty base suggests that the court's statements are largely dicta. Nevertheless, essential patent owners and technology users should stay alert to these issues as the case proceeds through appeal.

4. *De Facto Exclusive Dealing or Vigorous Price Competition for Design Wins?*

Finally, while many commentators have focused on the theories relating to standard-essential patents and the antitrust duty to deal with competitors, the fate of the case on appeal could rest on the strength of the court's evaluation of the exclusionary impact of Qualcomm's conditional pricing and rebate policies. The law relevant to conditional pricing and *de facto* exclusive dealing is complex and varies to some extent across circuits, and the court did not appear to engage with the extensive cases and commentary differentiating pro- from anti-competitive uses of such policies. Although the court focuses on the factual details of Qualcomm's policy, it largely ignores the economic expert testimony regarding competitive effects. It instead relies on documentary evidence, which in the court's view shows anticompetitive intent, as the nearly sole basis for inferring anticompetitive effects. All companies that employ conditional pricing and loyalty rebates should stay tuned to how the appellate court handles these issues.

1. *FTC v. Qualcomm Inc.*, No. 17-CV-00220-LHK, 2019 WL 2206013 (N.D. Cal. May 21, 2019)
2. Statement of Interest of the United States of America, *FTC v. Qualcomm, Inc.*, No. 17-CV-00220-LHK (2019) (ECF No. 1487).
3. Press Release, FTC, Statement by Federal Trade Commission Bureau of Competition Director Bruce Hoffman on District Court Ruling in Agency's Monopolization Case against Qualcomm (May 22, 2019).
4. Christine Wilson, Op-Ed, *A Court's Dangerous Antitrust Overreach*, Wall St. J. (May 28, 2019); Press Release, FTC, Statement of Commissioner Rohit Chopra on the Ruling by Judge Lucy Koh in *Federal Trade Commission v. Qualcomm Incorporated* (May 22, 2019).
5. The court found that Qualcomm had violated Section 5 of the FTC Act by engaging in monopolization and unreasonable restraints of trade under legal standards that apply to Sections 1 and 2 of the Sherman Act. The court stated expressly that it did not reach the FTC's claim that Qualcomm's behavior also constitutes a separate "unfair method of competition." So its legal conclusions rest solely on its interpretation of Sections 1 and 2 of the Sherman Act.
6. *Qualcomm,* 2019 WL 2206013, at *26.
7. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).
8. *Qualcomm,* 2019 WL 2206013, at *56.
9. After trial but before the court issued its decision, Qualcomm settled a separate antitrust case with Apple and entered a new patent license and modem chip supply agreement that includes next generation 5G technology. Immediately after the settlement and new supply agreement were announced, Intel announced that it was exiting the market for 5G modem chips. Brian Fung, *What This Week's Apple-Qualcomm-Intel Dance Means for the Future of 5G* Wash. Post (Apr. 18, 2019).
10. *Qualcomm*, 2019 WL 2206013, at *133
11. *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008).
12. *Qualcomm*, 2019 WL 2206013, at *29–30.
13. *In re Indep. Serv. Orgs. Antitrust Litig.*,203 F.3d 1322, 1325 (Fed. Cir. 2000); U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition 17 (2007) (discussing *Image Tech. Servs., Inc. v. Eastman Kodak Co*., 125 F.3d 1195 (9th Cir. 1997)).
14. *Ericsson, Inc. v. D-Link Sys., Inc.*, 773 F.3d 1201, 1231 (Fed. Cir. 2014).
15. *Qualcomm*, 2019 WL 2206013, at *75–76 (citing *Microsoft Corp. v. Motorola, Inc.,* 795 F.3d 1024, 1031 (9th Cir. 2015) and *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 87.
16. Commonwealth Sci. & Indus. Research Organisation v. Cisco Sys., 809 F.3d 1295 (Fed. Cir. 2015).