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BLOG

Sharp Elbows and Profit-Maximizing Licensing Ruled Insufficient Evidence of Anticompetitive Conduct in *FTC v. Qualcomm, Inc.*

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As many anticipated, the Ninth Circuit reversed Judge Koh's ruling that Qualcomm, Inc. had an antitrust duty to deal with its rival chip makers. The panel criticized Judge Koh for focusing on harm to downstream original equipment manufacturer (OEM) customers rather than on actual anticompetitive effects in the purportedly restrained chip market and rejected Judge Koh's reliance on the smallest saleable unit test underlying her conclusion that Qualcomm's royalty rates were unreasonably high. *FTC v. Qualcomm, Inc.*, No. 19-16122, 2020 U.S. App. LEXIS 25347 (9th Cir. Aug. 11, 2020). Importantly, the Ninth Circuit ruled that the FTC failed to prove that Qualcomm engaged in anticompetitive conduct because Qualcomm's "no license, no chips" policy was "chip-supplier neutral" in that it applied to all sales, regardless of which supplier sold an OEM customer chips, so no rivals were disadvantaged. *Id.* at *14-15. By effectively giving rivals indemnification agreements, Qualcomm instead employed a "no license, no problem" policy with respect to rival chip makers. *Id.* at *37.

The Ninth Circuit held that Qualcomm did not violate the narrow exception to the rule that even a monopolist has no duty to deal with or aid its rivals.

The court articulated what will now be a three-prong test in the Ninth Circuit for a duty to deal claim, noting that a monopolist engages in prohibited, anticompetitive conduct when:

1. It unilaterally terminates a voluntary and profitable course of dealing;
2. The only conceivable rationale or purpose is to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition; and
3. The refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers.

Id. at *33-34.

As was expected given the FTC's concession that Judge Koh erred in holding that Qualcomm had, and violated, a duty to deal with rival chip makers, the Ninth Circuit held that the facts did not satisfy any prong of this test. *Id.* at *37-38. First, Judge Koh inappropriately relied on a single email from before Qualcomm had monopoly power to find Qualcomm previously supplied exhaustive Standard Essential Patent (SEP) licenses to rival chip-makers. *Id.* at *34-35. The FTC presented no evidence that Qualcomm provided exhaustive licenses at the chip rather than OEM level since it gained monopoly power. *Id.* Second, licensing at the OEM level was never done to sacrifice short-term benefits to exclude competitors in the long run. *Id.* at *35-36. To the contrary, OEM-level licensing is admittedly more lucrative and intended to maximize profits, but profit-seeking behavior alone is insufficient to support antitrust liability. *Id.* Third, Qualcomm did not use its policy to single out or disadvantage rivals, but rather applied its OEM-level licensing policy equally with respect to all competitors and declined to enforce patents against rivals even though they practiced Qualcomm's patents royalty-free. *Id.* at *36-37.

Among other things, this decision will be cited heavily by defendants going forward for the line that while "anticompetitive behavior is illegal under the antitrust laws, hypercompetitive conduct is not," and that while Qualcomm asserted its "economic muscle" with "sharp elbows," as companies often do, it did so with "vigor, imagination, devotion, and ingenuity." *Id.* at *62.

The Ninth Circuit arguably went further than it needed to reverse Judge Koh's duty to deal ruling by making several points that will be helpful to patent holders going forward.

- ***A breach of a FRAND commitment alone does not violate Section 2 of the Sherman Act and FRAND disputes are better governed by contract and patent law.***

  The Ninth Circuit explicitly applied the *Colgate* doctrine in the context of novel licensing practices and profit-maximizing royalty rates, holding that businesses are free to choose with whom they deal as well as the prices, terms, and conditions of that dealing, even where a breach of a FRAND commitment has been alleged. *Qualcomm*, 2020 U.S. App. LEXIS 25347, at *43 (citing *United States v. Colgate Co.*, 250 U.S. 300, 307 (1919)). The court rejected the FTC's request to hold that Qualcomm's alleged breach of its Standard Setting Organization (SSO) commitments to license its SEPs on FRAND terms, even assuming there was a breach, amounted to anticompetitive conduct in violation of Section 2 of the Sherman Act. *Id.* at *40-41. The Ninth Circuit noted further that "the rules of contract and patent law are better equipped to handle commercial disputes between the world's most sophisticated companies about FRAND agreements." *Id.* at *42-43.

- ***There is no per se rule for reasonable royalty calculations based on the smallest salable patent-practicing unit ("SSPPU") test.***

  The Ninth Circuit observed that Judge Koh misinterpreted Federal Circuit law in concluding that Qualcomm was not entitled to a royalty based on a cellular handset versus a modem chip. *Id.* at *45. The smallest salable unit test is a tool to minimize jury confusion when weighing expert testimony about patent damages that is not even required by the Federal Circuit for determining patent damages. *Id.* at *46. There is nothing inherently anticompetitive about parties agreeing to base a royalty on a "percentage of the commercial products' sale price" and "using the market value of the entire product." *Id.* at *46-47. The Ninth Circuit accordingly held that the district court's "anticompetitive surcharge" theory failed to state a cogent theory of anticompetitive harm because it was premised on a misunderstanding of Federal Circuit law pertaining to the calculation of patent damages; incorrectly conflated antitrust liability and patent law liability; and it improperly considered "anticompetitive harms to OEMs" that fell outside the relevant antitrust chip markets. *Id.* at *44-45.

- ***Royalties are not inherently anticompetitive if they do not precisely reflect a patent's current, intrinsic value and are not in line with the rates other companies charge for their own patent portfolios.***

  The Ninth Circuit was careful to reject a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the fair value of its SEP portfolio corresponds to the prices the market appears willing to pay for those SEPs in the form of licensing royalty rates. *Id.* at *47-48. However, the court chose not to weigh in on whether it is appropriate in the antitrust context to use the "established royalty" rule to assess the reasonableness of a royalty rate using the claimant's established royalties because its holding did not depend on the reasonableness of Qualcomm's royalties. *Id.* at *47-48 & n.20.

- ***Avoiding multi-level licensing may be procompetitive, more efficient, and may justify licensing only at the OEM level.***

The Ninth Circuit credited Qualcomm's "procompetitive justification" that licensing at the OEM and chip-supplier levels simultaneously would require the company to engage in "multi-level licensing," leading to inefficiencies and less profit. *Id.* at *39-40. However, despite noting that OEM-licensing appeared "reasonable and consistent with current industry practice," it did mention that it was less critical of this justification because the FTC had not met its burden of showing harm in the allegedly restrained chip markets. *Id.* at *40. The Ninth Circuit cited Nokia's amicus brief noting there "are good reasons for SEP owners to structure their licensing programs to license end-user products," including the reduction of "transaction costs and complexities associated with negotiating and executing licenses at multiple points in the supply chain," the avoidance of "overlapping and duplicative licensing," "expedite[d] access to SEPs for the entire supply chain," and "greater visibility to what products are actually licensed, for example, for auditing purposes." *Id.* at *40, n.17 (quoting Br. of Amicus Curiae Nokia Technologies Oy at 18-19). The court also cited Dolby Laboratories, Inc.'s amicus brief for the point that "[f]orcing SEP holders to license component suppliers would interfere with historical precedents and established practices, and produce significant inefficiencies and lack of transparency regarding whether products in the stream of commerce are in fact licensed." *Id.* (quoting Br. of Amicus Curiae Dolby Laboratories, Inc.).

While taking a disciplined approach to the assessment of actual anticompetitive effects in the allegedly restrained chip markets, the Ninth Circuit was careful to distinguish two important cases articulating particular licensing conduct that may be sufficiently anticompetitive to support an antitrust claim.

- ***Intentional Deception, SSO Reliance, and Discriminatory Licensing May State an Antitrust Claim.***

While rejecting the FTC's argument that a breach of a FRAND commitment alone is sufficient anticompetitive conduct to state a claim under Section 2 of the Sherman Act, *id.* at *40-43, the Ninth Circuit distinguished the Third Circuit's decision in *Broadcom Corp. v. Qualcomm, Inc.* on the basis that an intentionally false promise coupled with an SSO's reliance thereon, followed by discriminatory, *i.e.,* anticompetitive, pricing can still suffice to state a monopolization claim. 501 F.3d 297, 303 (3d Cir. 2007). This adds a new gloss on *Broadcom*, suggesting that the actionable conduct is not just the manipulation of the standard-setting process, but the subsequent discriminatory pricing used to disadvantage rivals, which gives more protection to novel licensing and pricing frameworks so long as they are applied in a non-discriminatory manner to rivals. Query whether this will lead to a split with the Third Circuit. Expect to see more claims filed in the Third Circuit than the Ninth going forward, particularly when combined with downstream exclusive-dealing conduct analogous to the Third Circuit decisions in *United States v. Dentsply*, *LePage's, Inc. v. 3M Co.*, and *ZF Meritor, LLC v. Eaton Corp.*, which were decided in plaintiffs' favor. *Dentsply*, 399 F.3d 181 (3d Cir. 2005); *LePage's*, 324 F.3d 141 (3d Cir. 2003); *ZF Meritor*, 696 F.3d 254 (3d Cir. 2012).

- ***Requiring Royalties for Products Not Covered by Patent States a Claim.***

The Ninth Circuit also distinguished the *Caldera, Inc. v. Microsoft Corp.* case in which Microsoft required OEMs to pay a royalty for every machine shipped regardless of the operating system such that OEMs had to pay two royalties (one for MS-DOS and one for another operating system) unless they chose exclusively to install Microsoft's operating system. 87 F. Supp. 2d 1244 (D. Utah 1999). In contrast to the per-unit operating system royalties at issue in *Caldera*, the court noted that a license from Qualcomm is necessary to each OEM's ability to market and sell its cellular products to consumers regardless of whether the OEM uses Qualcomm's chips or a rival's because Qualcomm holds patents practiced by its rivals' chips such that Qualcomm is entitled to collect a royalty when another company's chips are used as well. *Qualcomm*, 2020 U.S. App. LEXIS 25347, at *49-52. In contrast, the Ninth Circuit noted that if "Qualcomm were to refuse to license its SEPs to OEMs unless they first agreed to purchase Qualcomm's chips ("no chips, no license"), then rival chip suppliers indeed might have an antitrust claim under both Sections 1 and 2 of the Sherman Act based on exclusionary conduct. *Id.* at *55-56. This is because OEMs cannot sell their products *without* obtaining Qualcomm's SEP licenses, so a "no chips, no license" policy would essentially force OEMs to either purchase Qualcomm's chips or pay for *both* Qualcomm's and a competitor's chips (similar to the no-win situation faced by OEMs in the *Caldera* case). *Id.* Thus, Qualcomm's conduct did not amount to exclusive dealing, and the court observed that the specific supply agreement with Apple that was at issue had already ended in any event. *Id.* at *57-62.

To summarize, the Ninth Circuit set out its high level rulings as follows:

1. Qualcomm's practice of licensing its SEPs exclusively at the OEM level does not amount to anticompetitive conduct in violation of § 2, as Qualcomm is under no antitrust duty to license rival chip suppliers. To the extent Qualcomm has breached any of its FRAND commitments, a conclusion the court needed not and did not reach, the remedy for such a breach lies in contract and patent law.
2. Qualcomm's patent-licensing royalties and "no license, no chips" policy do not impose an anticompetitive surcharge on rivals' modem chip sales. Instead, these aspects of Qualcomm's business model are "chip-supplier neutral" and do not undermine competition in the relevant antitrust markets.
3. Qualcomm's 2011 and 2013 agreements with Apple have not had the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market. Furthermore, because these agreements were terminated years ago by Apple itself, there is nothing to be enjoined.

Id. at *62-63.

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Authors

Susannah Torpey

Aldo A. Badini

Jeffrey Kessler

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Susannah Torpey

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